COMMERCIAL NATIONAL FINANCIAL CORP /PA
Form 10-Q
November 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2003
o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _______ to _______

Commission file number 0-18676

COMMERCIAL NATIONAL FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1623213
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

900 LIGONIER STREET LATROBE, PA	15650
(Address of principal executive offices)	*(Zip Code)*

Registrant's telephone number, including area code: (724) 539-3501

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes[X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [x] No

Indicate the number of shares outstanding of each of the issuer's classes of common stock.

CLASS	OUTSTANDING AT OCTOBER 31, 2003
Common Stock, $2 Par Value	3,430,368 Shares

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Page

PART II - OTHER INFORMATION

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2003	**December 31, 2002**
	(unaudited)	
ASSETS		
Cash and due from banks	$ 11,344,906	$ 10,294,276
Interest bearing deposits with		
other banks	251,787	20,633,629
Total cash and cash equivalents	11,596,693	30,927,905
Federal funds sold	16,225,000	14,650,000
Investment securities available for sale	124,568,599	144,726,216
Restricted investments in bank stock	3,819,100	3,618,200
Loans (all domestic)	189,673,906	169,030,225
Allowance for loan losses	(2,674,279)	(2,707,323)
Net loans	186,999,627	166,322,902

Premises and equipment	4,690,304	4,523,920
Other assets	16,079,020	15,568,612
Total assets	$363,978,343	$380,337,755
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits (all domestic):		
Non-interest bearing	$ 52,208,984	$ 51,355,652
Interest bearing	205,156,190	218,669,557
Total deposits	257,365,174	270,025,209
Other liabilities	2,742,779	4,108,044
Long-term borrowings	55,000,000	55,000,000
Total liabilities	315,107,953	329,133,253
Shareholders' equity:		
Common stock, par value $2; 10,000,000		
shares authorized; 3,600,000 issued;		
3,430,368 and 3,453,952 shares outstanding		
in 2003 and 2002, respectively	7,200,000	7,200,000
Retained earnings	42,161,221	41,627,977
Accumulated other comprehensive income -		
net of deferred taxes of $1,373,575		
in September 2003 and $2,514,488 in		
December 2002	2,666,351	4,881,064
Treasury stock, at cost, 169,632 and 146,048 shares in		
2003 and 2002, respectively	(3,157,182)	(2,504,539)
Total shareholders' equity	48,870,390	51,204,502
Total liabilities and		
shareholders' equity	$363,978,343	$380,337,755

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30 (unaudited)		Nine Months Ended September 30 (unaudited)	
	2003	2002	2003	2002
INTEREST INCOME:				
Interest and fees on loans	$ 2,894,505	$ 3,347,171	$ 8,635,083	$ 10,477,596
Interest and dividends on securities:				
Taxable	1,386,251	2,198,599	5,270,385	5,963,971
Exempt from federal income taxes	385,827	261,422	977,816	784,105
Other	36,592	66,377	160,682	130,313
Total interest income	4,703,175	5,873,569	15,043,966	17,355,985
INTEREST EXPENSE				
Interest on deposits	827,614	1,241,810	2,750,275	3,878,780
Interest on short-term borrowings	-	10,556	-	29,651
Interest on long-term borrowings	734,144	740,032	2,178,499	1,818,790
Total interest expense	1,561,758	1,992,398	4,928,774	5,727,221
NET INTEREST INCOME	3,141,417	3,881,171	10,115,192	11,628,764
PROVISION FOR LOAN LOSSES	-	96,000	-	298,030

NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	3,141,417	3,785,171	10,115,192	11,330,734
OTHER OPERATING INCOME:				
Asset management and trust income	162,249	144,448	513,174	415,466
Service charges on deposit accounts	236,570	186,899	639,644	541,227
Other service charges and fees	127,644	150,067	458,026	546,564
Commissions and fees from insurance sales	204,235	46,299	689,207	76,278
Income from investment in life insurance	122,208	147,948	420,384	323,514
Gain from sale of branch	-	469,782	-	469,782
Other income	128,894	93,172	265,762	252,904
Total other operating income	981,800	1,238,615	2,986,197	2,625,735
OTHER OPERATING EXPENSES:				
Salaries and employee benefits	1,619,603	1,442,185	4,588,992	4,268,174
Net occupancy	169,808	169,018	540,128	473,285
Furniture and equipment	174,913	176,254	523,426	527,009
Pennsylvania shares tax	126,813	115,807	373,101	340,602
Other expenses	1,015,755	912,700	3,214,698	2,561,806
Total other operating expenses	3,106,892	2,815,964	9,240,345	8,170,876
INCOME BEFORE INCOME TAXES	1,016,325	2,207,822	3,861,044	5,785,593
Income tax expense	146,475	477,700	743,885	1,462,700
Net income	$ 869,850	$ 1,730,122	$ 3,117,159	$ 4,322,893
Average Shares Outstanding	3,436,539	3,425,348	3,445,324	3,425,348
Earnings Per Share, basic	$ 0.25	$ 0.50	$ 0.90	$ 1.26
Dividends Paid Per Share	$ 0.25	$ 0.25	$ 0.75	$ 0.75

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock	**Retained Earnings**	**Treasury Stock**	**Accumulated Other Comprehensive Income**	**Total Shareholders' Equity**
(unaudited)					
Balance at December 31, 2002	$7,200,000	$41,627,977	$(2,504,539)	$ 4,881,064	$51,204,502
Comprehensive Income					
Net income	-	3,117,159	-	-	3,117,159
Other comprehensive income, net of tax:					
Unrealized net losses on securities	-	-	-	(2,214,713)	(2,214,713)
Total Comprehensive Income					902,446
Cash dividends declared					
$.75 per share	-	(2,583,915)	-	-	(2,583,915)
Purchase of treasury stock	-	-	(652,643)	-	(652,643)
Balance at September 30, 2003	$7,200,000	$42,161,221	$(3,157,182)	$ 2,666,351	$48,870,390
(unaudited)					
Balance at December 31, 2001	$7,200,000	$39,736,355	$(3,125,420)	$ 2,159,362	$45,970,297
Comprehensive Income					

Net income	-	4,322,893	-	-	4,322,893
Other comprehensive income, net of tax:					
Unrealized net gains on securities	-	-	-	3,091,373	3,091,373
Total Comprehensive Income					7,414,266
Cash dividends declared					
$.75 per share	-	(2,569,297)	-	-	(2,569,297)
Purchase of treasury stock	-	-	(153,392)	-	(153,392)
Balance at September 30, 2002	$7,200,000	$41,489,951	$(3,278,812)	$ 5,250,735	$50,661,874

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For Nine Months Ended September 30	
	2003	2002
OPERATING ACTIVITIES		
Net income	$3,117,159	$4,322,893
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	471,007	476,593
Amortization of intangibles	152,547	9,751
Provision for loan losses	-	298,030
Gain on sale of branch	-	(469,782)
Net accretion of securities	(522,406)	(523,509)
Income from investment in life insurance	(420,384)	(323,514)
Decrease in other liabilities	(248,280)	(394,742)
Increase in other assets	(118,778)	(1,076,114)
Net cash provided by operating activities	2,430,865	2,319,606
INVESTING ACTIVITIES		
Increase in fed funds sold	(1,575,000)	(13,150,000)
Purchase of securities	(41,206,907)	(60,466,998)
Maturities and calls of securities	58,330,403	33,170,478
Net cash used in acquisition	(99,864)	-
Investment in life insurance	-	(5,000,000)
Net proceeds from sale of branch	-	469,782
Net (increase) decrease in loans	(20,676,725)	24,315,371
Proceeds from sale of premises and equipment	-	1,141,748
Purchase of premises and equipment	(637,391)	(501,744)
Net cash used in investing activities	(5,865,484)	(20,021,363)
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	(12,660,035)	9,681,662
Decrease in other short-term borrowings	-	(4,275,000)
Proceeds from long-term borrowings	-	20,148,271
Dividends paid	(2,583,915)	(2,569,297)
Purchase of treasury stock	(652,643)	(153,392)
Net cash provided by financing activities	(15,896,593)	22,832,244
Increase (decrease) in cash and cash equivalents	(19,331,212)	5,130,487
Cash and cash equivalents at beginning of year	30,927,905	10,112,268
Cash and cash equivalents at end of quarter	$11,596,693	$15,242,755
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 5,146,121	$ 5,789,543
Income Taxes	$ 421,000	$ 1,494,743
Supplemental schedule of non-cash investing and		

financing activities		
Transfer of residential loans to foreclosed real estate	$ 160,828	$ 344,049

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2003

Note 1 Basis of Presentation

The accompanying consolidated financial statements include the accounts of Commercial National Financial Corporation (the Corporation) and its wholly owned subsidiaries, Commercial Bank of Pennsylvania (the Bank), formerly known as Commercial National Bank of Pennsylvania, and Commercial National Insurance Services, Inc., (CNIS). In December 2002, CNIS acquired The Gooder Agency Inc., (Gooder). Gooder is a full service provider of insurance products to individuals and businesses and acts as an agent for fifteen national, regional and mutual insurance companies. Gooder's results of operations are not material to the consolidated financial statements. In July 2003, the Bank's application to convert to a Pennsylvania state chartered bank was approved by the Pennsylvania Department of Banking, and the Bank changed its name to Commercial Bank of Pennsylvania. In October 2003, the Corporation's application to form a trust company was approved. This subsidiary, Highview Trust Company (HTC), enables the Corporation to offer more investment products and the Corporation's current trust operations will be transferred to HTC from the Bank. All material intercompany transactions have been eliminated.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. However, they do not include all information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the annual financial statements of the Corporation for the year ended December 31, 2002, including the notes thereto. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of financial position as of September 30, 2003 and the results of operations for the three and nine months periods ended September 30, 2003. The results of operations for the three and nine months ended September 30, 2003 are not necessarily indicative of the results to be expected for the entire year.

Note 2 Allowance for Loan Losses

The provision for loan losses is the amount added to the allowance against which actual loan losses are charged. The amount of the provision is determined by management through an evaluation of the size and quality of the loan portfolio, economic conditions, concentrations of credit, recent loan loss trends, delinquencies and other risks inherent within the loan portfolio. Based upon the Corporation's most recent quarterly evaluation, management considers the allowance for loan losses to be adequate to absorb any losses that may occur in the loan portfolio.

The Corporation recorded no provision for the three and nine-month periods ended September 30, 2003. By comparison, the Corporation charged to expense $298,030 for the nine month period ended a year ago. Net charge-offs amounted to $33,044 and $97,539 for the nine months ended September 30, 2003 and 2002, respectively.

Description of changes:

	2003	2002
Allowance balance January 1	$2,707,323	$2,814,454
Additions:		
Provision charged to operating expenses	-	298,030
Recoveries on previously charged off Loans	28,465	33,236
Deductions:		
Loans charged off	(61,509)	(130,775)
Allowance balance September 30	$ 2,674,279	$ 3,014,945

COMMERCIAL NATIONAL FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 Comprehensive Income

The components of other comprehensive income (loss) and related tax effects for the three and nine month periods ended September 30, 2003 and 2002 are as follows:

	For three months Ended September 30		For nine months Ended September 30	
	2003	2002	2003	2002
Gross change in unrealized gains (losses) on securities available for sale	$ (2,259,127)	$2,032,042	$(3,355,626)	$4,683,898
Tax effect	(768,103)	394,655	(1,140,913)	1,592,525
Net of tax amount	$ (1,491,024)	$1,637,387	$(2,214,713)	$3,091,373

Note 4 Legal Proceedings

Other than proceedings which occur in the normal course of business, there are no legal proceedings to which either the Corporation or any of its subsidiaries is a party which, in the opinion of management, will have any material effect on the financial position of the Corporation and its subsidiaries.

Note 5 Acquisition

On January 3, 2003, the Corporation acquired certain insurance agency accounts from an employee of the Corporation's insurance agency subsidiary, Gooder. The Corporation paid cash of $99,864 for the accounts. The acquisition has been accounted for as a purchase and the results of operations are included in the consolidated financial statements since the date of the acquisition. The impact of the acquisition on the Corporation's results of operations for the period ended September 30, 2003 was not material.

Note 6 New Accounting Standards

In July 2002, the Financial Accounting Standards Board issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which nullifies EITF Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This statement delays recognition of these costs until liabilities are incurred, rather than at the date of commitment to the plan, and requires fair value measurement. It does not impact the recognition of liabilities incurred in connection with a business combination or the disposal of long-lived assets. The provisions of this statement are effective for exit or disposal activities initiated after December 31, 2002 and are not expected to have a significant impact on the Corporation's financial condition or results of operations.

In November 2002, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This Interpretation expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees and requires the guarantor to recognize a liability for the fair value of an obligation assumed under certain specified guarantees. FIN 45 clarifies the requirements of FASB Statement No. 5, "Accounting for Contingencies." In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying factor that is related to an asset, liability or equity security of the guaranteed party, which would include financial and standby letters of credit. Certain guarantee contracts are excluded from both the disclosure and recognition requirements of this Interpretation, including, among others, guarantees related to commercial letters of credit and loan commitments. The disclosure requirements of FIN 45 require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The accounting recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002. Adoption of FIN 45 did not have a significant impact on the Corporation's financial condition or results of operations.

COMMERCIAL NATIONAL FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The Bank's exposure to credit loss in the event of noncompliance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Bank had $3,392,494 of outstanding letters of credit as of September 30, 2003. The Bank uses the same credit policies in making conditional commitments as it does for on-balance sheet instruments.

Of these letters of credit, $322,245 automatically renew within the next twelve months, $70,044 will expire within the next twelve months and $3,000,205 will expire within thirteen to one hundred and eighty months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank may require collateral and personal guarantees supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral and the enforcement of personal guarantees would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees.

In April 2003, the Financial Accounting Standards Board issued Statement No. 149, "Amendment of Statement No. 133, Accounting for Derivative Instruments and Hedging Activities". This statement clarifies the definition of a derivative and incorporates certain decisions made by the Board as part of the Derivatives Implementation Group process. This statement is effective for contracts entered into or modified, and for hedging relationships designated after September 30, 2003 and should be applied prospectively. The provisions of the Statement that relate to implementation issues addressed by the Derivatives Implementation Group that have been effective should continue to be applied in accordance with their respective effective dates. Adoption of this standard is not expected to have any impact on the Corporation's financial condition or results of operations.

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51". This interpretation provides new guidance for the consolidation of variable interest entities (VIEs) and requires such entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risk among parties involved. The interpretation also adds disclosure requirements for investors that are involved with unconsolidated VIEs. The disclosure requirements apply to all financial statements issued after January 31, 2003. The consolidation requirements apply immediately to VIEs created after January 31, 2003 and are effective for the first fiscal year or interim period beginning after December 15, 2003 for VIEs acquired before February 1, 2003. The adoption of this interpretation did not have any impact on the Corporation's financial condition or results of operations.

In May 2003, the Financial Accounting Standards Board issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement requires that an issuer classify a financial instrument that is within its scope as a liability. Many of these instruments were previously classified as equity. This Statement was effective for financial instruments entered into or modified after May 31, 2003 and otherwise was effective beginning July 1, 2003. The adoption of this standard did not have any impact on the Corporation's financial condition or results of operations.

MANAGEMENT'S DISCU

ITEM 2.