

COMMERCIAL NATIONAL FINANCIAL CORP /PA
Form 10-Q
May 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarter ended MARCH 31, 2002

-

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 (I.R.S. Employer Identification No.)
or organization)*

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 []

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

| <u>CLASS</u> | <u>OUTSTANDING AT APRIL 30, 2002</u> |
|-----------------------------|--------------------------------------|
| Common Stock, \$2 Par Value | 3,426,096 Shares |

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Included in Part I of this report:

Commercial National Financial Corporation

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| | | |
|--|---------------|---------------|
| Federal funds sold | - | - |
| Investment securities available for sale | 138,502,155 | 119,396,065 |
| Loans (all domestic) | 195,872,894 | 202,406,350 |
| Unearned income | (31,285) | (71,186) |
| Allowance for loan losses | (2,797,865) | (2,814,454) |
| Net loans | 193,043,744 | 199,520,710 |
| Premises and equipment | 5,808,207 | 5,707,705 |
| Other assets | 8,489,470 | 8,291,810 |
| Total assets | \$352,516,483 | \$343,028,558 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits (all domestic): | | |
| Non-interest bearing | \$ 45,808,290 | \$ 47,942,276 |
| Interest bearing | 207,723,955 | 207,044,496 |
| Total deposits | 253,532,245 | 254,986,772 |
| Short-term borrowings | 15,675,000 | 4,275,000 |
| Other liabilities | 1,929,269 | 2,796,489 |
| Long-term borrowings | 35,167,555 | 35,000,000 |
| Total liabilities | 306,304,069 | 297,058,261 |
| Shareholders' equity: | | |
| Common stock, par value \$2; 10,000,000 | | |
| shares authorized; 3,600,000 issued; | | |
| 3,426,096 shares outstanding | | |
| in 2002 and 2001 | 7,200,000 | 7,200,000 |
| Retained earnings | 40,274,711 | 39,736,355 |
| Accumulated other comprehensive income - | | |
| net of deferred taxes of \$959,791 | | |
| in March 2002 and \$1,112,399 in | | |
| December 2001 | 1,863,123 | 2,159,362 |
| Treasury stock, at cost, 173,904 shares in | | |
| 2002 and 2001, respectively | | |
| | (3,125,420) | (3,125,420) |
| Total shareholders' equity | 46,212,414 | 45,970,297 |
| Total liabilities and | | |
| shareholders' equity | \$352,516,483 | \$343,028,558 |

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

| COMMERCIAL NATIONAL FINANCIAL CORPORATION | | |
|---|-------------|-------------|
| CONSOLIDATED STATEMENTS OF INCOME | | |
| | March 31 | March 31 |
| | <u>2002</u> | <u>2001</u> |
| INTEREST INCOME: | | |
| Interest and fees on loans | \$3,729,944 | \$4,330,625 |
| Interest and dividends on investments: | | |

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| | | |
|---|-------------|-------------|
| Taxable interest | 1,768,123 | 1,540,525 |
| Interest exempt from federal income tax | | |
| Interest on federal funds sold | 20,534 | 87,036 |
| Interest on bank deposits | 1,562 | 17,448 |
| Total interest income | 5,781,588 | 6,162,552 |
| INTEREST EXPENSE | | |
| Interest on deposits | 1,348,142 | 2,265,974 |
| Interest on short-term borrowings | 12,001 | 22,644 |
| Interest on long-term borrowings | 441,688 | 220,029 |
| Total interest expense | 1,801,831 | 2,508,647 |
| NET INTEREST INCOME | 3,979,757 | 3,653,905 |
| Provision for loan losses | 39,214 | - |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 3,940,543 | 3,653,905 |
| OTHER INCOME | | |
| Asset management and trust income | 126,077 | 146,861 |
| Service charges on deposit accounts | 182,958 | 183,913 |
| Other service charges and fees | 220,992 | 210,423 |
| Net securities losses | - | (24,565) |
| Other income | 157,435 | 67,971 |
| Total other income | 687,462 | 584,603 |
| OTHER EXPENSES | | |
| Salaries and employee benefits | 1,454,294 | 1,413,823 |
| Net occupancy expense | 154,562 | 169,716 |
| Furniture and equipment expense | 169,776 | 173,784 |
| Pennsylvania shares tax | 108,988 | 99,863 |
| Other expense | 809,805 | 667,854 |
| Total other expenses | 2,697,425 | 2,525,040 |
| INCOME BEFORE TAXES | 1,930,580 | 1,713,466 |
| Income tax expense | 535,700 | 477,600 |
| NET INCOME | \$1,394,880 | \$1,235,866 |
| Average shares outstanding | 3,426,096 | 3,446,543 |
| EARNINGS PER SHARE | \$.41 | \$.36 |

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

| COMMERCIAL NATIONAL FINANCIAL CORPORATION | | | | | |
|--|-------------|--------------|---------------|---------------|---------------|
| CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY | | | | | |
| | | | | Accumulated | |
| | | | | Other | Total |
| | Common | Retained | Treasury | Comprehensive | Shareholders' |
| | Stock | Earnings | Stock | Income | Equity |
| Balance at December 31, 2001 | \$7,200,000 | \$39,736,355 | \$(3,125,420) | \$ 2,159,362 | \$45,970,297 |
| Comprehensive Income | | | | | |
| Net income | - | 1,394,880 | - | - | 1,394,880 |
| Other comprehensive income, net of tax: | | | | | |
| Unrealized gains on securities | - | - | - | (296,239) | (296,239) |
| Total Comprehensive Income | | | | | 1,098,641 |
| Cash dividends declared | | | | | |
| \$.25 per share | - | (856,524) | - | - | (856,524) |
| Purchase of treasury stock | - | - | - | - | - |
| Balance at March 31, 2002 | \$7,200,000 | \$40,274,711 | \$(3,125,420) | \$ 1,863,123 | \$46,212,414 |
| Balance at December 31, 2000 | \$7,200,000 | \$37,438,970 | \$(2,596,335) | \$ 1,094,282 | \$43,136,917 |
| Comprehensive Income | | | | | |
| Net income | - | 1,235,866 | - | - | 1,235,866 |
| Other comprehensive income, net of tax: | | | | | |
| Unrealized net gains on securities | | | | | |
| of \$1,033,152, net of reclassification | | | | | |
| adjustment for losses included in net | | | | | |
| income of \$15,722 | - | - | - | 1,048,874 | 1,048,874 |
| Total Comprehensive Income | | | | | 2,284,740 |
| Cash dividends declared | | | | | |
| \$.17 per share | - | (653,637) | - | - | (653,637) |
| Purchase of treasury stock | - | - | (376,858) | - | (376,858) |
| Balance at March 31, 2001 | \$7,200,000 | \$38,021,199 | \$(2,973,193) | \$ 2,143,156 | \$44,391,162 |

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

COMMERCIAL NATIONAL FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For Three Months

Ended March 31

20022001

OPERATING ACTIVITIES

| | | |
|--|-------------|-------------|
| Net income | \$1,394,880 | \$1,235,866 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 159,639 | 172,424 |
| Provision for loan losses | 39,214 | - |
| Net accretion/(amortization) of securities and loan fees | (211,659) | (26,755) |
| (Increase) decrease in interest receivable | (131,625) | 177,160 |
| Decrease in interest payable | (250,644) | (186,988) |
| Decrease in taxes receivable | 68,537 | 161,065 |
| Decrease in other liabilities | (532,504) | (470,141) |
| (Increase) decrease in other assets | (66,035) | 147,981 |
| Net security losses | - | 24,565 |
| Net cash provided by operating activities | 469,803 | 1,235,177 |

INVESTING ACTIVITIES

| | | |
|--|--------------|--------------|
| Net (increase) decrease in deposits with other banks | 418,704 | (10,421,070) |
| Increase in fed funds sold | - | (13,350,000) |
| Purchase of securities AFS | (29,939,746) | - |
| Maturities and calls of securities AFS | 10,556,566 | 3,223,475 |
| Proceeds from sales of securities AFS | - | 4,754,262 |
| Net decrease in loans | 6,477,653 | 781,404 |
| Purchase of premises and equipment | (260,141) | (151,104) |
| Net cash used in investing activities | (12,746,964) | (15,163,033) |

FINANCING ACTIVITIES

| | | |
|--|-------------|-------------|
| Net decrease in deposits | (1,454,527) | (2,688,534) |
| Increase (decrease) in other short-term borrowings | 11,400,000 | (7,575,000) |

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| | | |
|---|--------------|--------------|
| Proceeds from long-term borrowings | 167,555 | 25,000,000 |
| Repayment of long-term borrowings | — | — |
| Dividends paid | (856,524) | (653,637) |
| Purchase of treasury stock | — | (376,858) |
| Net cash provided by financing activities | 9,256,504 | 13,705,971 |
| | (3,020,657) | (221,885) |
| Cash and cash equivalents at beginning of year | 9,512,523 | 9,532,528 |
| Cash and cash equivalents at end of quarter | \$ 6,491,866 | \$ 9,310,643 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the year for: | | |
| Interest | \$ 2,052,475 | \$ 2,695,635 |
| Income Taxes | \$ — | \$ — |
| Supplemental schedule of non-cash investing and Financing activities | | |
| Transfer of residential loans to foreclosed real estate | \$ 49,616 | \$ 55,792 |
| The accompanying notes are an integral part of these consolidated financial statements. | | |

COMMERCIAL NATIONAL FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2002

Note 1 Management Representation

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 Commercial National Financial Corporation for the year ending December 31, 2001, 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 March 31, 2002 and the results of operations for the three month periods ended March 31, 2002 and 2001, and the statements of cash flows and changes in shareholders' equity for the three month periods ended March 31, 2002 and 2001. The results of the three months ended March 31, 2002 are not necessarily indicative of the results to be expected for the entire year.

Note 2 Allowance for Loan Losses

Description of changes:

| | <u>2002</u> | <u>2001</u> |
|---|--------------|--------------|
| Allowance balance January 1 | \$2,814,454 | \$2,736,712 |
| Additions: | | |
| Provision charged to operating expenses | 39,214 | - |
| Recoveries on previously charged off | | |
| Loans | 13,628 | 14,439 |
| Deductions: | | |
| Loans charged off | (69,431) | (40,349) |
| Allowance balance March 31 | \$ 2,797,865 | \$ 2,710,802 |

Note 3 Comprehensive Income

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Comprehensive income was \$(296,239) and \$1,048,874 for the three months ended March 31, 2002 and 2001. The difference between comprehensive income and net income presented in the Consolidated Statements of Shareholders' Equity is attributed solely to unrealized gains and losses on available-for-sale securities during the periods presented.

Note 4 Legal Proceedings

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

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

Overview

In light of the economic effects of the recent terrorist attacks, and the slowdown already experi

The corporation is making positive movements regarding the previously announced changes in its co

Financial Condition

Total assets at March 31, 2002 increased \$9,487,925 since the end of 2001. The increase was due to

Average earning assets represented 93.22% of average total assets for the first three months of 2002.

The decrease in deposits of \$1,454,527 from December 31, 2001 to March 31, 2002 is due mainly to

Shareholders' equity was \$46,212,414 on March 31, 2002 compared to \$45,970,297 on December 31, 2001.

RESULTS OF OPERATIONS

First Three Months of 2002 as compared to the First Three Months of 2001

Pre-tax net income for the first three months of 2002 was \$1,930,581 compared to \$1,713,467 during the same period of 2001, representing a 12.67% increase.

Interest income was \$5,781,588, a decrease of 6.18%. The loan return rate decreased eighty-seven (87) basis points to 7.49%. This was due to 450 basis points of easing enacted by the Federal Reserve and the refinancing of mortgages by our customers to take advantage of these lower rates. The securities return rate decreased only nine (9) basis points to 6.83%. As a result, the return rate on total average earning assets decreased sixty-three (63) basis points to 7.24%. Average earning asset volume rose \$6,225,958, a 1.99% increase.

Interest expense was \$1,801,832, a decrease of 28.18%, which is attributed to a decline in market interest rates and external funding interest rates. The cost rate on average interest-bearing liabilities was 2.93%, a one hundred and twenty-nine (129) basis points decrease from a year ago. Average interest-bearing liabilities volume rose by \$8,262,863, which represented an increase of 3.48%.

Net interest income rose 8.92% to \$3,979,756, and represented 4.82% of average total assets compared to 4.43% during the first three months of 2001.

The average allowance for loan losses increased 19.71% to \$2,783,438. By comparison, total average loans declined 3.85% during the same period. The increase in the allowance is the result of an enhanced credit review process that identifies problem loans more readily. With the implementation of this process, additional money was allocated to bring the reserve in balance. There was a provision for loan losses of \$39,214 during the first three months of 2002 and no provision was allocated for the first quarter of 2001.

Net interest income after the application of the provision for loan losses increased \$286,637 to \$3,940,542, representing a 7.84% return on total average assets compared to 6.94% for the first three months of 2001.

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Non-interest income increased 17.59% to \$687,462. Asset management and trust fees totaled \$126,077, representing a 14.15% decrease. A decline in estate management fees is the primary cause of this decrease. Service charges on deposit accounts remained relatively unchanged at \$182,958. Other service charges and fees increased 5.02% and were \$220,992. Other income increased substantially by 131.62% to \$157,435. This increase is the result of bank-owned life insurance income that the corporation purchased for key employees during May of 2001.

Non-interest expense reached \$2,697,425, an increase of 6.83%, or \$172,384, while total average assets increased 3.76%. Personnel costs rose 2.86%, which equates to a \$40,471 increase. Net occupancy decreased 8.93%, or \$15,154. Furniture and equipment expense declined 2.31%, representing a cost decrease of \$4,008. Pennsylvania shares tax expense was \$108,988, an increase of 9.14%. Other expense grew by 21.25%, representing a \$141,951 increase. This increase is mainly due to increases in legal and consulting fees associated with collection and credit review of loans.

Federal income tax on total first three months earnings was \$535,700 compared to \$477,600 a year ago. Net income after taxes increased \$159,014 to \$1,394,881, an increase of 12.87%. The annualized return on average assets was 1.63% for the first three months of 2002 compared to 1.50% for the three months ended March 31, 2001. The annualized return on average equity through March 31, 2002 was 11.93% and had been 11.28% through the first three months of 2001.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS (Continued)

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RESULTS OF OPERATIONS (Continued)

LIQUIDITY

Liquidity, the measure of the corporation's ability to meet the normal cash flow needs of depositors and borrowers in an efficient manner, is generated primarily from the acquisition of deposit funds and the maturity of loans and securities. Additional liquidity can be provided by the sale of investment securities available for sale that amounted to \$135,654,547 with net unrealized gains of \$2,822,914 on March 31, 2002. The bank is a member of the Federal Home Loan Bank (FHLB) system. The FHLB provides an additional source of liquidity for long and short-term funding. Additional short-term funding is available through federal funds lines of credit that are established with correspondent banks.

During the first three months of 2002, average interest-bearing liabilities increased \$8,262,863 over the same period in 2001. As of March 31, 2002, there was \$9,563,214 in securities scheduled to mature within the next year.

INTEREST SENSITIVITY

Interest rate management seeks to maintain a balance between consistent income growth and the risk that is created by variations in ability to reprice deposit and investment categories. The effort to determine the effect of potential interest rate changes normally involves measuring the so called "gap" between assets (loans and securities) subject to rate fluctuation and liabilities (interest bearing deposits) subject to rate fluctuation as related to earning assets over different time periods and calculating the ratio of interest sensitive assets to interest sensitive liabilities.

Repricing periods for the loans, securities, interest bearing deposits, non-interest bearing assets and non-interest bearing liabilities are based on contractual maturities, were applicable, as well as the corporation's historical experience regarding the impact of interest rate fluctuations on the prepayment and withdrawal patterns of certain assets and liabilities. Regular savings, NOW and other similar interest bearing demand deposit accounts are subject to immediate withdrawal without penalty and therefore are presented as beginning to reprice in the earliest period presented in the "gap" table.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**AND RESULTS OF OPERATIONS (Continued)****RESULTS OF OPERATIONS (Continued)**

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INTEREST SENSITIVITY (In thousands)

The following table presents this information as of March 31, 2002 and December 31, 2001:

| | March 31, 2002 | | | | | |
|--|-----------------------|-------------------|--------------------|---------------------|--------------------|-------------------|
| | 0-30 DAYS | 31-90 DAYS | 91-180 DAYS | 181-365 DAYS | 1 - 5 YEARS | OVER 5 YRS |
| Interest-earning assets: | | | | | | |
| Securities | \$ 3,122 | \$ 6,244 | \$ 9,359 | \$ 17,288 | \$84,012 | \$ 13,272 |
| Federal funds sold and other deposits with banks | 181 | - | - | - | - | - |
| Loans | 27,837 | 3,225 | 4,519 | 11,210 | 89,016 | 56,956 |
| Total interest-sensitive assets | 31,140 | 9,469 | 13,878 | 28,498 | 173,028 | 70,228 |
| Interest-bearing liabilities: | | | | | | |
| Certificates of deposits | 7,828 | 12,882 | 21,306 | 21,234 | 18,508 | 2,954 |
| Other interest-bearing liabilities | - | 5,040 | 5,040 | 8,358 | 46,981 | 58,593 |
| Other-term borrowings | 15,675 | - | - | - | 25,168 | 10,000 |
| Total-interest sensitive liabilities | 23,503 | 17,922 | 26,346 | 29,592 | 90,657 | 71,547 |
| Interest sensitivity gap | \$ 7,637 | \$(8,453) | \$(12,468) | \$(1,094) | \$82,371 | \$ (1,319) |
| Cumulative gap | \$ 7,637 | \$ (816) | \$(13,284) | \$(14,378) | \$ 67,993 | \$ 66,674 |
| Ratio of cumulative gap to earning assets | 2.30% | (0.25%) | (4.01%) | (4.34%) | 20.52% | 20.12% |

| | December 31, 2001 | | | | | |
|--|--------------------------|-------------------|--------------------|---------------------|--------------------|-------------------|
| | 0-30 DAYS | 31-90 DAYS | 91-180 DAYS | 181-365 DAYS | 1 - 5 YEARS | OVER 5 YRS |
| Interest-earning assets: | | | | | | |
| Securities | \$ 3,755 | \$ 7,507 | \$ 11,265 | \$ 23,083 | \$54,610 | \$ 13,522 |
| Federal funds sold and other deposits with banks | 600 | - | - | - | - | - |
| Loans | 27,613 | 3,679 | 5,230 | 9,589 | 93,079 | 60,486 |
| Total interest-sensitive assets | 31,968 | 11,186 | 16,495 | 32,672 | 147,689 | 74,008 |
| Interest-bearing liabilities: | | | | | | |
| Certificates of deposits | 14,627 | 16,694 | 19,051 | 19,236 | 20,020 | 1,615 |

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| | | | | | | |
|---|------------------|-------------------|-------------------|-------------------|------------------|------------------|
| Other interest-bearing liabilities | - | 4,695 | 4,695 | 6,868 | 44,129 | 55,416 |
| Other-term borrowings | 4,275 | 5,000 | - | - | 25,000 | 5,000 |
| Total-interest sensitive liabilities | 18,902 | 26,389 | 23,746 | 26,104 | 89,149 | 62,031 |
| Interest sensitivity gap | \$ 13,066 | \$(15,203) | \$ (7,251) | \$ 6,568 | \$ 58,540 | \$ 11,977 |
| Cumulative gap | \$ 13,066 | \$ (2,137) | \$ (9,388) | \$ (2,820) | \$ 55,720 | \$ 67,697 |
| Ratio of cumulative gap to earning assets | 4.09% | (0.67%) | (2.94%) | (0.88%) | 17.43% | 21.18% |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**AND RESULTS OF OPERATIONS (Continued)****CREDIT QUALITY RISK**

The following table presents a comparison of loan performance as of March 31, 2002 with that of March 31, 2001. Non-accrual loans are those for which interest income is recorded only when received and past due loans are those which are contractually past due 90 days or more in respect to interest or principal payments. The increase in non-accrual loans is due to the general economic slowdown and the corporation's implementation of an enhanced loan assessment program. The assessment enhances the corporation's ability to identify loans which may be problems or which the borrower may be unable to pay under the terms of the original agreement. On March 31, 2002, \$813,054 of the non-accrual loans were current with payments recognized on a cash basis only. As of March 31, 2002 the corporation had \$49,616 in foreclosed real estate.

At March 31

| | <u>2002</u> | <u>2001</u> |
|--|---------------------|---------------------|
| Non-performing Loans: | | |
| Loans on non-accrual basis | \$2,847,375 | \$ 742,143 |
| Past due loans | 89,548 | 153,678 |
| Renegotiated loans | <u>59,854</u> | <u>156,904</u> |
| Total Non-performing Loans | <u>2,996,777</u> | <u>1,052,725</u> |
| Foreclosed real estate | <u>49,616</u> | <u>55,792</u> |
| Total non-performing assets | \$ <u>3,046,393</u> | \$ <u>1,108,517</u> |
| Loans outstanding at end of period | \$195,841,609 | \$207,085,806 |
| Average loans outstanding (year-to-date) | \$196,375,044 | \$207,130,922 |
| Non-performing loans as a percent of total | | |
| Loans | 1.56% | .54% |
| Provision for loan losses | \$ 39,214 | \$ - |
| Net charge-offs as a percent of average | | |
| Loans | .03% | .01% |
| Provision for loan losses as a | | |
| Percent of net charge-offs | 70.27% | .00% |
| Allowance for loan losses as a | | |
| Percent of average loans outstanding | 1.43% | 1.31% |

CAPITAL RESOURCES

Shareholders' equity for the first three months of 2002 averaged \$46,772,950 which represented an increase of \$2,957,034 over the average capital of \$43,815,916 recorded in the same period of 2001. These capital levels represented a capital ratio of 13.28% in 2002 and 13.66% in 2001. When the loan loss allowance is included, the 2002 capital ratio becomes 14.47%.

The Federal Reserve Board's risk-based capital guidelines are designed principally as a measure of credit risk. These guidelines require that: (1) at least 50% of a banking organization's total capital be common and certain other "core" equity capital ("Tier I Capital"); (2) assets and off-balance sheet items must be weighted according to risk; and (3) the total capital to risk-weighted assets ratio be at least 8.00%; and (4) a minimum 3.00% leverage ratio of Tier I capital to average total assets be maintained for financial institutions that meet certain specified criteria, including asset quality, high liquidity, low interest-rate exposure and the highest regulatory rating. As of March 31, 2002, the corporation, under these guidelines, had a Tier I and total equity capital to risk adjusted assets ratio of 23.34% and 24.59% respectively. The leverage ratio was 13.09%.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**AND RESULTS OF OPERATIONS (Continued)****CAPITAL RESOURCES (continued)**

The table below presents the corporation's capital position at March 31, 2002

(Dollar amounts in thousands)

| | <u>Amount</u> | Percent of Adjusted <u>Assets</u> |
|----------------------------------|---------------|---|
| Tier I Capital | \$ 44,349 | 23.34 |
| Tier I Capital Requirement | 7,602 | 4.00 |
| Total Equity Capital | \$ 46,730 | 24.59 |
| Total Equity Capital Requirement | 15,203 | 8.00 |
| Leverage Capital | \$ 44,349 | 13.09 |
| Leverage Requirement | 13,549 | 4.00 |

—

—

—

—

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

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Asset/Liability management refers to management's efforts to minimize fluctuations in net interest income caused by interest rate changes. This is accomplished by managing the repricing of interest rate sensitive interest-earning assets and interest-bearing liabilities. Controlling

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the maturity or repricing of an institution's liabilities and assets in order to minimize interest rate risk is commonly referred to as gap management. Close matching of the repricing of assets and liabilities will normally result in changes in net interest income as interest rates change.

Management regularly monitors the interest sensitivity position and considers this position in its decisions with regard to the corporation's interest rates and maturities for interest-earning assets acquired and interest-bearing liabilities accepted.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 2. CHANGES IN SECURITIES

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

None were filed during the first quarter of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMMERCIAL NATIONAL FINANCIAL CORPORATION
(Registrant)

Dated: May 15, 2002

/s/ Gregg E. Hunter
Gregg E. Hunter, Vice Chairman
Chief Financial Officer

Dated: May 15, 2002

/s/ Ryan M. Glista
Ryan M. Glista
Vice President

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Commercial National Financial Corporation
900 Ligonier Street
Latrobe, Pennsylvania 15650
Telephone (724) 539-3501

Commercial National Bank of Pennsylvania

OFFICE LOCATIONS

Latrobe Area

| | |
|---------------------|----------------|
| 900 Ligonier Street | (724) 539-9963 |
| 1900 Lincoln Avenue | (724) 537-9980 |
| 11 Terry Way | (724) 539-9774 |

Pleasant Unity

| | |
|---------------|----------------|
| Church Street | (724) 423-5222 |
|---------------|----------------|

Ligonier

| | |
|-----------------|----------------|
| 201 Main Street | (724) 238-9538 |
|-----------------|----------------|

West Newton

| | |
|----------------------|----------------|
| 109 East Main Street | (724) 872-5100 |
|----------------------|----------------|

Greensburg Area

| | |
|-------------------------------------|----------------|
| Georges Station Road | (724) 836-7698 |
| 19 North Main Street | (724) 836-7699 |
| Asset Management and Trust Division | (724) 836-7670 |
| 19 North Main Street | |

Drive-up Facility

Latrobe

| | |
|----------------------------------|----------------|
| Lincoln Road at Josephine Street | (724) 537-9927 |
|----------------------------------|----------------|

Murrysville

| | |
|-------------------------------|----------------|
| 4785 Old William Penn Highway | (724) 733-4888 |
|-------------------------------|----------------|

In addition to the full-service ATM machines located at all Commercial National Bank community office indicated above (except Latrobe and Courthouse Square),

additional ATMs are available for your 24-hour banking convenience at Arnold Palmer Regional Airport, Latrobe Area Hospital, New Alexandria Qwik Mart,

Norvelt Open Pantry , Saint Vincent College and University of Pittsburgh at Greensburg. All are linked to the national Cirrus, Honor, Plus and STAR networks and also accept

MasterCard, Visa, Discover and American Express for cash advances.

Touchtone Teller 24-hour banking service: Website Address:
(724) 537-9977 www.cnbthebank.com

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Free from Blairsville, Derry,
Greensburg, Kecksburg, Latrobe,
Ligonier and New Alexandria.

1-800-803-BANK

Free from all other locations.

INSURANCE

Commercial National Insurance Services
232 North Market Street
Ligonier, PA 15658
724/238-4617
877/205-4617 (toll free)
724/238-0160 (fax)

cnisinfo@cnbinsurance.com

www.cnbinsurance.com

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