

COMMERCIAL NATIONAL FINANCIAL CORP /PA
Form 10-K
March 28, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE
ACT OF 1934
For the fiscal year ended December 31, 2006**

Commission file number 0-18676

COMMERCIAL NATIONAL FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA
*(State or other jurisdiction of incorporation
or organization)*

25-1623213
(I.R.S. Employer Identification No.)

900 LIGONIER STREET, LATROBE, PA
(Address of principal executive offices)

15650
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$2 Par Value
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act. Yes [] No [X]

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 checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. []

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer [] Accelerated Filer [] Non-accelerated Filer [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [] No [X]

The aggregate market value of registrant's outstanding voting common stock held by non-affiliates on June 30, 2006, the last business day of the registrant's most recently completed second fiscal quarter, was \$43,072,140.

Number of shares of common stock outstanding at March 1, 2007 3,044,813

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement relating to its 2007 annual meeting of shareholders to be held May 15, 2007 are incorporated by reference into Part III of this Form 10-K. In addition, portions of the registrant's Annual Report to Shareholders for the fiscal year ended December 31, 2006 are incorporated by reference into Part II of this Form 10-K.

Commercial National Financial Corporation

Form 10-K

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PART I

Item 1. BUSINESS

The Commercial National Financial Corporation (the "Corporation") is a Pennsylvania corporation and is registered as a bank holding company under the Bank Holding Company Act of 1956 as amended. Through its subsidiary the Corporation is engaged in banking and trust operations.

The Corporation is owner of 100% of the outstanding shares of common stock of Commercial Bank & Trust of PA (the "Bank") formerly known as Commercial Bank of Pennsylvania. The Bank has been providing banking services since 1934. At the present time, two (2) banking offices are in operation in Latrobe, Pennsylvania, two (2) in Unity Township, Pennsylvania and one (1) each in Ligonier, West Newton, Greensburg, Norwin and Hempfield Township, Pennsylvania. All of these offices are within the boundaries of Westmoreland County, Pennsylvania. In addition, the building that houses the Bank's downtown Latrobe banking office is the location of the Corporation's and the Bank's executive and administrative offices. The institution's operations center is located at the Latrobe Plaza in downtown Latrobe. This operations center also houses an in-house data processing system.

Each of the banking offices, except Greensburg, is equipped with a 24 hour a day automatic teller machine (ATM). Bank ATM units are also located on the campus of Saint Vincent College in Unity Township, the terminal of the Arnold Palmer Regional Airport, at the Latrobe Area Hospital and an in-store machine in the Norvelt Open Pantry. A separate freestanding drive-up teller staffed banking facility is attached to the Lincoln Road office in downtown Latrobe. This facility also provides ATM service.

The Bank offers the full range of banking services normally associated with a general commercial banking business. Services include extending credit, providing deposit services, marketing non-deposit investments and offering financial counseling. The ATM system described above is a part of the Cirrus, Honor, Plus and Star networks, which provides the Bank's customers access to an extensive regional and national network. The Bank also has implemented a comprehensive electronic Online Banking system. By using a personal computer with internet access, customers can access their Commercial Bank accounts, perform common banking tasks and pay bills 24 hours a day, seven days a week, 365 days a year.

The Corporation currently has one inactive subsidiary, Commercial National Insurance Services. There are no current plans for this subsidiary.

Competition

All aspects of the Corporation's business are highly competitive. The Corporation competes for deposits, loans and banking services with major financial institutions, several national and state banks, thrift institutions, credit unions, mortgage brokers, finance companies, insurance companies, investment companies and mutual funds.

Customers are generally influenced by convenience of location, quality of service, price of services and availability of products. The Corporation believes that it effectively competes with other financial service providers within its market area.

Supervision and Regulation

Introduction

The Corporation and the Bank are subject to extensive regulation by federal and state agencies. The primary focus of these regulations is for the protection of depositors, federal deposit insurance funds and the banking system, not for the protection of security holders. Set forth below is a brief description of certain laws which relate to the regulation of the Corporation and its subsidiaries. The description is not meant to be complete and is qualified by reference to applicable laws and regulations.

Holding Company. The Corporation, as a bank holding company is subject to regulation by the Federal Reserve Board (FRB), the Securities and Exchange Commission, and the Federal Deposit Insurance Corporation (FDIC). The nature of the supervision extends to such areas as safety and soundness, truth-in-lending, truth-in-savings, rate restrictions, consumer protection, permissible loan and securities activities, merger and acquisition limitations, reserve requirements, dividend payments and regulations concerning activities by corporate officers and directors. No regulatory restrictions or actions are currently pending against the Corporation.

Subsidiary Bank The Bank is subject to regulation and examination primarily by the FDIC and Commonwealth of Pennsylvania, Department of Banking (the "Department").

On July 19, 2005, the Board of Directors of the Bank entered into a Memorandum of Understanding with the Department and the FDIC. The Memorandum was terminated on June 13, 2006.

Capital Requirements

Bank holding companies are required to be in compliance with the FRB's risk-based capital standards. These standards require that (1) at least 50% of total capital must be "Tier 1 capital". This consists primarily of common and certain other "core" equity capital; (2) assets and off-balance sheet items must be weighted according to risk; (3) the total capital to risk-weighted asset ratio must be at least 8%; and (4) a minimum 4% leverage ratio of Tier 1 capital to average assets must be maintained. The Department requires state chartered banks to maintain a 6% leverage capital and 10% risk based capital, defined substantially the same as the federal regulations. The Bank is subject to almost identical capital requirements adopted by the FDIC.

Effects of Governmental Policies

In addition to regulatory requirements, the Corporation and its subsidiary Bank are affected by the national economy and the influence on that economy exerted by governmental bodies through monetary and fiscal policies and their efforts to implement such policies. In particular, the impact of the open market operations on interest rates, the establishment of reserve requirements and the setting of the discount rate will continue to affect business volumes and earnings. The exact nature or the full extent of this impact is almost impossible to predict; however, management continues to monitor these activities on a regular basis and seeks to modify its policies and procedures accordingly.

Employees

As of December 31, 2006, the Corporation employed 112 people in full- and part-time positions. Approximately 55 employees are represented by the United Auto Workers, Local 1799. In 2004, the Corporation and bargaining unit employees entered into a five-year labor agreement that will expire in February 2009.

Executive Officers of the Corporation

The following table shows the names and ages of the current executive officers and the present and previous positions held by them for at least the past five years.

| Name | Age | Present and Previous Positions |
|------------------------|-----|--|
| Gregg E. Hunter | 48 | Vice chairman, president and chief executive officer (February 2004 - present), Vice chairman and chief financial officer (December 1995 to January 2004) |
| Thomas D. Watters, CPA | 45 | Senior vice president and chief financial officer (July 2005-present), Chief Auditor (January 1998-July 2005) |
| Wendy S. Schmucker | 38 | Secretary/treasurer and senior vice president, division manager corporate administration (February 2004 - present) Secretary/treasurer and vice president, manager corporate administration (November 1997 to January 2004) |
| Susan R. Skoloda | 32 | Vice president, corporate controls and community relations officer (March 2004 to present); assistant vice president (April 2001 to February 2004); assistant secretary/treasurer (April 1998 to present) |

Item 1A. RISK FACTORS

The following are the key risk factors that management believes could have a negative impact to the Corporation's financial performance.

Interest rate volatility could significantly harm the Bank's business.

The Bank's results of operations are affected by the monetary and fiscal policies of the federal government and the regulatory policies of governmental authorities. A significant component of the Bank's earnings is its net interest income, which is the difference between the income from interest earning assets, such as loans, and the expense of

interest bearing liabilities, such as deposits. A change in market interest rates could adversely affect the Bank's earnings if market interest rates change such that the interest the Bank pays on deposits and borrowings increases faster than the interest it collects on loans and investments.

The Bank's results of operations are significantly affected by the ability of its borrowers to repay their loans.

The inability of borrowers to repay loans could erode our earnings and capital. Substantially all of our loans are to businesses and individuals in western Pennsylvania, and any economic decline in this market area could impact us adversely.

The majority of the Bank's business is concentrated in western Pennsylvania, which is traditionally a slower growth market than other areas of the United States. As a result, the Bank's loan portfolio and results of operations may be adversely affected by factors that have a significant impact on the economic conditions in this market area. The local economies of this market area historically have been less robust than the economy of the nation as a whole and may not be subject to the same fluctuations as the national economy. Adverse economic conditions in the Bank's market area, including the loss of certain significant employers, could reduce its growth rate, affect its borrowers' ability to repay their loans and generally affect the Bank's financial condition and results of operations. Furthermore, a downturn in real estate values in the Bank's market area could cause many of its loans to become inadequately collateralized.

The Bank's financial condition and results of operations would be adversely affected if its allowance for loan losses is not sufficient to absorb actual losses.

As a lender, the Bank is exposed to the risk that our borrowers may be unable to repay their loans and that collateral securing the payment of their loans may not be sufficient to assure repayment. Credit losses are inherent in the lending business and could have a material adverse effect on the operating results of the Bank. We make certain assumptions and judgments about the collectibility of our loan portfolio and provide an allowance for potential losses based on a number of factors. If these assumptions are incorrect, the allowance for credit losses may not be sufficient to cover losses, thereby having an adverse effect on operating results, and may cause us to increase the allowance in the future.

Changes in legislative or regulatory requirements applicable to the Corporation and its subsidiaries could increase costs, limit certain operations and adversely affect results of operations.

The banking industry is heavily regulated under both federal and state law. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution's growth and the return to its investors, by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, expansion of branch offices and the offering of securities or trust services. The Corporation is also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that its subsidiary bank is found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects, as well as those of the Corporation. The Corporation also cannot predict the nature or the extent of the effect on our business and earnings of new federal or state legislation. Further, the cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

The Bank's business and financial condition may be adversely affected by an increase in competition.

The Bank faces significant competition in attracting and retaining deposits and making loans as well as in providing other financial services throughout our market area. In addition to facing pricing competition for loans and deposits, the Bank also faces competition with respect to customer convenience, product lines, accessibility of service and service capabilities. The Bank's competition comes from other banks and savings institutions, brokerages, credit unions, government-sponsored enterprises, mutual fund companies, insurance companies and other non-bank businesses, many of which are larger in terms of total assets and capitalization, have greater access to the capital

markets and offer a broader array of financial services than the Bank does. Competition with such institutions may cause the Bank to increase its deposit rates or decrease its interest rate spread on loans it originates.

New litigation or changes in current litigation could adversely affect the Corporation's financial condition or results of operation.

Although there is currently no material litigation to which the Corporation is the subject, future litigation that arises during the normal course of business could be material and have a negative impact on the Corporation's earnings. Future litigation or changes in current litigation could also adversely impact the reputation of the Corporation in the communities that it serves.

Item 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

Item 2. PROPERTIES

All of the Corporation's facilities are owned with the exception of the Lincoln Road banking office and adjacent drive-up facility and the Norwin Hills banking office. All of the properties are used in their entirety for banking purposes. In each case, the properties have been maintained in good repair, are well suited for their present use and appear to be adequate for the immediate needs of the Corporation and its subsidiary. The locations of the Corporation's real properties can be found in the Annual Report to Shareholders.

Item 3. LEGAL PROCEEDINGS

The Corporation, in the normal course of business, is subject to various legal proceedings. Management does not expect the outcome of these proceedings to have a material adverse impact on the Corporation's financial condition or results of operations.

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

No matters were submitted to a vote of the Corporation's security holders during the last quarter of its fiscal year ended December 31, 2006.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Information appearing in the Annual Report to Shareholders for the fiscal year ended December 31, 2006 (the Annual Report) in the section titled "Common Stock Information" is incorporated herein by reference in response to this item. As of March 8, 2007 there were 445 shareholders of record of the Corporation's common stock. The number of beneficial shareholders is approximately 855.

We have historically paid quarterly dividends on our common stock and currently intend to continue to do so in the foreseeable future. Our ability to pay dividends depends on a number of factors, however, including restrictions on the ability of the Corporation to pay dividends under federal laws and regulations, and as a result there can be no assurance that dividends will be paid in the future.

In 2000, the Board of Directors authorized the repurchase of up to 360,000 shares of the Corporation's common stock from time to time when warranted by market conditions. There have been 193,074 shares purchased under this authorization through December 31, 2006.

The Corporation did not purchase any treasury stock during the quarter ended December 31, 2006.

Item 6. SELECTED FINANCIAL DATA

Information appearing in the Annual Report in the section titled "Selected Financial Data" is incorporated herein by reference.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information appearing in the Annual Report in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" is incorporated herein by reference.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information appearing in the Annual Report in the section titled "Interest Sensitivity and Market Risk" is incorporated herein by reference.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Corporation's consolidated financial statements, the notes thereto and the report of the independent registered public accounting firm of the Annual Report are incorporated herein by reference. In addition, a quarterly summary of financial data is in the section titled "Quarterly Summary of Financial Data" of the Annual Report is incorporated herein by reference.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

NONE.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Corporation maintains a system of disclosure controls and procedures that is designed to ensure that information required to be disclosed by the Corporation in this Form 10-K, and in other reports required to be filed under the Securities Exchange Act of 1934 (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms for such filings. Management of the Corporation, under the direction of the Corporation's Chief Executive Officer and Chief Financial Officer, reviewed and performed an evaluation of the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rules 13a-15a(e) and 15d-15(e) under the Exchange Act) as of December 31, 2006. Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer, along with other key management of the Corporation, have determined that the disclosure controls and procedures were and are effective as designed to ensure that material information relating to the Corporation and its consolidated subsidiaries required to be disclosed by the Corporation by the Exchange Act, was recorded, processed, summarized and reported within the applicable time periods.

Changes in Internal Controls

There have been no significant changes in our internal controls or in other factors that could significantly affect our internal controls during the quarter ended December 31, 2006.

Item 9B. OTHER INFORMATION

NONE.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE

Information concerning (i) directors, appearing under the captions "Election of Directors" and "Director's Meetings and Committees" in the Corporation's Proxy Statement, related to the Annual Meeting of Shareholders to be held May 15, 2007 (the "Proxy Statement") (ii) information concerning executive officers, appearing under the caption "Executive Officers of the Registrant" in Part I of this Form 10-K, and (iii) information contained under the section "Section 16(a) Beneficial Ownership Reporting Compliance", in the Proxy Statement, are incorporated herein by reference to this Item 10.

The Corporation has adopted a Code of Ethics for Senior Financial Officers which is applicable to the Corporation's principal executive officer and principal financial and accounting officer. A copy of such Code of Ethics has been filed as an exhibit to this Form 10-K.

Item 11. EXECUTIVE COMPENSATION

The information contained in the Corporation's Proxy Statement under the following sections is hereby incorporated into this Item 11: (i) "Compensation Discussion and Analysis," (ii) "Summary Compensation Table," (iii) "Compensation Committee Report," (iv) "Compensation of Directors," and "Director Compensation Table."

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information contained in the sections titled "Beneficial Ownership of Common Stock" and "Beneficial Ownership by Officers, Directors and Nominees" in the Proxy Statement is incorporated herein by reference to this Item 12.

Equity Compensation Plan Information

NONE

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information contained in the section titled “Related Party Transactions” as part of the “Compensation Discussion and Analysis,” in the Proxy Statement is incorporated herein by reference to this Item 13.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information contained in the section titled “Auditor and Audit Fees” in the Proxy Statement is incorporated by reference to this Item 14.

PART IV**Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) The consolidated financial statements and exhibits listed below are filed as part of this report. Financial statement schedules are omitted as they are not applicable.

(1) The Corporation's consolidated financial statements, the notes thereto and the report of the independent registered public accounting firm of the Annual Report and are incorporated herein by reference.

| Exhibit Number | Description | Page Number or Incorporated by Reference to |
|----------------|---|---|
| 3.1 | Articles of Incorporation | Exhibit C to Form S-4 Registration Statement Filed April 9, 1990 |
| 3.2 | By-laws of Registrant | Exhibit D to Form S-4 Registration Statement Filed April 9, 1990 |
| 3.3 | Amended Articles of Incorporation | Exhibit 3.6 to Form 10-Q Filed for the quarter ended September 30, 2004 |
| 3.4 | Amended Bylaws of Registrant | Exhibit 3.8 to Form 10-Q Filed for the quarter ended September 30, 2004 |
| 10.1 | Employment agreement between Gregg E. Hunter and Commercial Bank of Pennsylvania | Exhibit 10.1 to Form 10-Q for the Quarter ended September 30, 2003 |
| 10.3 | Mutual Release and Non-Disparagement Agreement between Commercial Bank of Pennsylvania and Louis T. Steiner | Exhibit 10-3 to Form 10-K for the period ended December 31, 2003. |
| 13 | Portions of the Annual Report to Shareholders for the Fiscal year Ended December 31, 2006 | Filed herewith |
| 14 | Code of Ethics for Senior Financial Officers | Filed herewith |
| 21 | Subsidiaries of the Registrant | Filed herewith |
| 31.1 | | Filed herewith |

Rule 13a-14(a)/15d-14(a) Certification
of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification Filed herewith
of Chief Financial Officer

32.1 Section 1350 Certification of Chief Executive Officer Filed herewith

32.2 Section 1350 Certification of Chief Financial Officer Filed herewith

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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)

By:/s/ Gregg E. Hunter
Gregg E. Hunter, Vice Chairman, President
and Chief Executive Officer

March 20, 2007

By:/s/ Thomas D. Watters
Thomas D. Watters, Senior Vice President
and Chief Financial Officer

March 20, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| SIGNATURE AND CAPACITY | DATE |
|--|----------------|
| /s/ George V. Welty George V. Welty, Chairman of the Board and Director | March 20, 2007 |
| /s/ Gregg E. Hunter Gregg E. Hunter, Vice Chairman of the Board, Director, Chief Executive Officer (principal executive officer) | March 20, 2007 |
| /s/ Thomas D. Watters Thomas D. Watters , Senior Vice President and Chief Financial Officer (principal financial and accounting officer) | March 20, 2007 |
| /s/ Wendy S. Schmucker Wendy S. Schmucker, Secretary/Treasurer | March 20, 2007 |
| /s/ John T. Babilya John T. Babilya, Director | March 20, 2007 |
| /s/ George A. Conti, Jr. George A. Conti Jr., Director | March 20, 2007 |
| /s/ Richmond H. Ferguson Richmond H. Ferguson, Director | March 20, 2007 |
| /s/ Dorothy S. Hunter Dorothy S. Hunter, Director | March 20, 2007 |
| /s/ Frank E. Jobe Frank E. Jobe, Director | March 20, 2007 |
| /s/ Steven H. Landers Steven H. Landers, Director | March 20, 2007 |
| /s/ Joseph A. Mosso Joseph A. Mosso, Director | March 20, 2007 |
| /s/ Bruce A. Robinson Bruce A. Robinson, Director | March 20, 2007 |
| /s/ Debra L. Spatola | March 20, 2007 |

Debra L. Spatola, Director

/s/ C. Edward Wible
C. Edward Wible, Director

March 20, 2007

EXHIBIT TABLE OF CONTENTS

| Exhibit Number | Description |
|-------------------|--|
| 13 | Portions of the Annual Report to Shareholders for the Fiscal Year Ended December 31, 2006 |
| 14 | Code of Ethics for Senior Financial Officers |
| 21 | Subsidiaries of the Registrant |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32.1 | Section 1350 Certification of Chief Executive Officer |
| 32.2 | Section 1350 Certification of Chief Financial Officer |

Exhibit 21 - Subsidiaries of Commercial National Financial Corporation

| Subsidiary | State or Jurisdiction of Incorporation |
|--|---|
| Commercial Bank & Trust of PA | Pennsylvania |
| Commercial National Insurance Services, Inc. | Pennsylvania |

The Corporation will provide without charge to any shareholder a copy of its 2006 annual report on Form 10-K as required to be filed with the Securities and Exchange Commission. Requests should be made in writing to:

COMMERCIAL NATIONAL FINANCIAL CORPORATION
STOCK TRANSFER DEPARTMENT
ATTN: WENDY SCHMUCKER
P.O. BOX 429
LATROBE, PA 15650

BUS_EST:223882-6