COMMERCIAL NATIONAL FINANCIAL CORP /PA
Form 10-Q
May 15, 2006

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 March 31, 2006

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 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. (Check one):

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 [x] No

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

CLASS	OUTSTANDING AT May 9, 2006
Common Stock, $2 Par Value	3,051,313 Shares

17

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PART II - OTHER INFORMATION

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except per share amounts)

		March 31, 2006 unaudited		December 31, 2005
ASSETS				
Cash and due from banks	$	9,733	$	12,760
Interest bearing deposits with banks		147		121
Total cash and cash equivalents		9,880		12,881
Federal funds sold		11,975		16,950
Investment securities available for sale		62,879		66,117
Restricted investments in bank stock		997		1,013
Loans receivable		213,510		207,039
Allowance for loan losses		(1,627)		(1,636)
Net loans		211,883		205,403
Premises and equipment, net		4,197		4,301
Investment in life insurance		13,050		12,940
Other assets		3,015		2,776
Total assets	$	317,876	$	322,381
LIABILITIES AND SHAREHOLDERS' EQUITY				
Deposits (all domestic):				
Non-interest bearing	$	65,964	$	69,025
Interest bearing		213,881		207,984
Total deposits		279,845		277,009
Other liabilities		1,526		1,711
Total liabilities		281,371		278,720
Shareholders' equity:				
Common stock, par value $2 per share; 10,000,000 shares authorized; 3,600,000 issued; 3,051,313 shares outstanding in 2006 and 3,413,426 shares outstanding in 2005		7,200		7,200
Retained earnings		39,277		39,422
Accumulated other comprehensive income		305		617
Treasury stock, at cost, 548,687 shares in 2006 and 186,574 shares in 2005		(10,277)		(3,578)
Total shareholders' equity		36,505		43,661

Total liabilities and shareholders' equity	$	317,876	$	322,381

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

17

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)

	Three Months Ended **March 31** **2006** (unaudited)	Three Months Ended **March 31** **2005** (unaudited)
INTEREST INCOME:		
Interest and fees on loans	$ 3,003	$ 2,710
Interest and dividends on investments:		
Taxable	881	1,266
Exempt from federal income tax	33	34
Other	171	4
Total interest income	4,088	4,014
INTEREST EXPENSE		
Interest on deposits	1,199	1,016
Interest on short-term borrowings	-	16
Total interest expense	1,199	1,032
NET INTEREST INCOME	2,889	2,982
POVISION (CREDIT) FOR LOAN LOSSES	30	(470)
NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES	2,859	3,452
OTHER INCO ME		
Asset management and trust income	209	207
Service charges on deposit accounts	164	127
Other service charges and fees	201	194
Income from investment in life insurance	129	126
Other income	43	62
Total other income	746	716
OTHER OPERATING EXPENSES		
Salaries and employee benefits	1,311	1,384
Net occupancy expense	196	177
Furniture and equipment expense	166	181
Pennsylvania shares tax	140	138
Legal and professional	301	127
Other expense	758	725
Total other expenses	2,872	2,732
INCOME BEFORE INCOME TAXES	733	1,436
Income tax expense	195	395
NET INCOME	$ 538	$ 1,041

Average shares outstanding		3,381,238		3,413,426
EARNINGS PER SHARE, BASIC	$	.16	$	.31

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

17

COMMERCIAL NATIONAL FINANCIAL Corporation
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(dollars in thousands, except per share data)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Shareholders' Equity
(unaudited)					
Balance at December 31, 2005	$7,200	$39,422	$(3,578)	$617	$43,661
Comprehensive Income					
Net income	-	538	-	-	538
Other comprehensive loss, net of tax:					
Unrealized net losses on securities		-	-	(312)	(312)
Total Comprehensive Income					226
Cash dividends declared					
$.20 per share	-	(683)		-	(683)
Purchase of treasury stock					
(362,113 shares)			(6,699)		(6,699)
Balance at March 31, 2006	$7,200	$39,277	$ (10,277)	$ 305	$36,505
(unaudited)					
Balance at December 31, 2004	$7,200	$38,946	$(3,578)	$2,092	$44,660
Comprehensive Income					
Net income	-	1,041	-	-	1,041
Other comprehensive loss, net of tax:					
Unrealized net losses on securities		-	-	(991)	(991)
Total Comprehensive Income					50
Cash dividends declared					
$.25 per share	-	(853)	-	-	(853)
Balance at March 31, 2005	$7,200	$39,134	$ (3,578)	$ 1,101	$43,857

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

17

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	For Three Months Ended March 31 2006	2005
OPERATING ACTIVITIES		
Net income	$ 538	$ 1,041
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	137	159
Amortization of intangibles	24	24
Provision/(credit) for loan losses	30	(470)
Net accretion of loans and securities	(12)	(11)
Income from investment in life insurance	(129)	(126)
Increase (decrease) in other liabilities	(25)	93
Increase in other assets	(243)	(356)
Net cash provided by operating activities	320	354
INVESTING ACTIVITIES		
Decrease in federal funds sold	4,975	-
Purchase of securities	(520)	-
Maturities and calls of securities	3,300	7,168
Redemption of restricted investments in bank stock	16	579
Net increase in loans	(6,513)	(1,793)
Purchase of premises and equipment	(33)	(134)
Net cash provided by investing activities	1,225	5,820
FINANCING ACTIVITIES		
Net increase in deposits	2,836	254
Decrease in other short-term borrowings	-	(3,525)
Dividends paid	(683)	(853)
Purchase of treasury stock	(6,699)	-
Net cash used in financing activities	(4,546)	(4,124)
Increase (decrease) in cash and cash equivalents	(3,001)	2,050
Cash and cash equivalents at beginning of year	12,881	7,786
Cash and cash equivalents at end of quarter	$ 9,880	$ 9,836
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,168	$ 1,049
Income Taxes	$ 140	$ -

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

17

COMMERCIAL NATIONAL FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2006

Note 1 Basis of Presentation

The accompanying consolidated financial statements include the accounts of Commercial National Financial Corporation (the Corporation) and its wholly owned subsidiary, Commercial Bank & Trust of PA. 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, 2005, 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, 2006 and the results of operations for the three-month period ended March 31, 2006. The results of operations for the three months ended March 31, 2006 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.

The Corporation recorded a $30,000 provision for the three-month period ended March 31, 2006. By comparison, during the Corporation's first quarter 2005 evaluation, management considered the allowance for loan losses to be over allocated by $470,000. Due to this overage, the Corporation reduced the allowance for loan losses by $470,000. The reason for this reduction is attributed to the Corporation receiving funds from the settlement of a lawsuit from a previously charged-off commercial loan. The proceeds, less legal costs associated with such loan, amounted to $285,000. The remaining credit is related to the pay down of a classified loan relationship, which had a specific allowance allocation.

Description of changes:

(dollars in thousands)	2006	2005
Allowance balance January 1	1,636	$1,855
Provision/(credit) charged to operating expenses	30	(470)
Recoveries on previously charged off loans	5	291
Loans charged off	(44)	(30)
Allowance balance March 31	$1,627	$1,646

17

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 month periods ended March 31, 2006 and 2005 are as follows: (dollars in thousands)

	For three months ended March 31	
	2006	2005
Gross change in unrealized (losses) on securities available for sale	$ (472)	$ (1,501)
Less: reclassification adjustment for gains		
Realized in income	-	-
Net unrealized (losses)	(472)	(1,501)
Tax effect	(160)	(510)
Net of tax amount	$ (312)	$ (991)

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 Guarantees

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to secure the performance of a customer to a third party. Of these letters of credit, $359,000 automatically renew within the next twelve months, $30,000 will expire within the next twelve months and $3,752,000 will expire within thirteen to one hundred and sixty-one months. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The current amount of the liability as of March 31, 2006 for guarantees under standby letters of credit issued is not material.

Note 6 Earnings per share

The Corporation has a simple capital structure. Basic earnings per share equals net income divided by the weighted average common shares outstanding during each period presented. The weighted average common shares outstanding for the three months ended March 31, 2006 and 2005 was 3,381,238 and 3,413,426 respectively.

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

SAFE HARBOR STATEMENT

Forward-looking statements (statements which are not historical facts) in this Quarterly Report on Form 10-Q are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the generality of the foregoing, words such as "may," "will," "to," "expect," "believe," "anti "intend," "could," "would," "estimate," or "continue" or the negative or other variations thereof or comparable terminolog intended to identify forward-looking statements. These statements are based on information currently available to the Corporation, and the Corporation assumes no obligation to update these statements as circumstances change. Investors are cautioned that all forward-looking statements involve risk and uncertainties, including changes in general economic and financial market conditions, unforeseen credit problems, and the Corporation's ability to execute its business plans. The actual results of future events could differ materially from those stated in any forward-looking statements herein.

CRITICAL ACCOUNTING ESTIMATES

Disclosure of the Corporation's significant accounting policies is included in Note 1 to the Corporation's Consolidated Financial Statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005 (the 2005 Annual Report). Some of these policies are particularly sensitive, requiring that significant judgments, estimates and assumptions be made by management. Additional information is contained in the Management's Discussion and Analysis section of the 2005 Annual Report for the most sensitive of these issues, including the provision and allowance for loan losses.

Significant estimates are made by management in determining the allowance for loan losses. Management considers a variety of factors in establishing these estimates, including current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strengths of borrowers, adequacy of collateral (if collateral dependent) and other relevant factors. Estimates related to the value of collateral also have a significant impact on whether or not the Corporation continues to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded in the Consolidated Statements of Financial Condition. Management discussed the development and selection of critical accounting estimates and related Management and Discussion and Analysis disclosure with the Corporation's Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within.

OVERVIEW

The Corporation had net income of $538,000 or $0.16 per share, for the first quarter ended March 31, 2006 compared to $1.0 million or $0.31 per share for the quarter ended March 31, 2005. The Corporation's return on average assets for the first quarter of 2006 and 2005 was .68% and 1.31%, respectively. Return on average equity for the same two periods was 4.97% and 9.32%, respectively.

The Corporation purchased 362,113 shares of it's own common stock in the first quarter of 2006. The legal and professional costs associated with the repurchase were $150,000 expensed in the first quarter 2006. In addition, the Corporation incurred additional director costs, as a result of the due diligence process prior to the stock repurchase. The repurchase was the major item impacting the first quarter 2006 net income. By comparison, the first quarter of

2005 benefited from the $470,000 credit for loan losses noted above in Note 2.

The Corporation's largest segment of operating results is dependent upon net interest income. Net interest income is interest earned on interest-earning assets less interest paid on interest-bearing deposits. For the first quarter ended March 31, 2006 and 2005, net interest income was $2.9 million and $3.0 million, respectively.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION

The Corporation’s total assets decreased by $4.5 million, or 1.40%, from December 31, 2005 to March 31, 2006. Federal funds and investments decreased by $8.2 million. Cash was lower by $3.0 million. These decreases were offset by $6.5 million increase in loans outstanding. Federal funds sold are lower due to the repurchase of stock noted earlier under **Overview**. Investment securities available for sale declined due to normal principal pay downs on mortgage-backed securities. The increase in loans in the first quarter of 2006 is a result of increases in both the commercial and consumer loan portfolios.

The Corporation’s total deposits increased $2.8 million from December 31, 2005 to March 31, 2006. Interest-bearing deposits had strong growth, $5.9 million in the first quarter of 2006 due to certificates of deposit promotions. This increase was partially offset by a decrease in non-interest bearing accounts.

Shareholders' equity was $36.5 million on March 31, 2006 compared to $43.7 million on December 31, 2005. Total shareholders equity decreased due to the $6.7 million used to purchase treasury stock, $683,000 in dividends paid, and a decrease in fair value of securities, decreasing equity by $312,000. The fair value of securities decreased because of higher bond market rates, which decreased the market value of the Corporation’s securities available for sale. These decreases were partially offset by net income of $538,000. Book value per common share decreased from $12.79 at December 31, 2005 to $11.97 at March 31, 2006.

RESULTS OF OPERATIONS

First Three Months of 2006 as compared to the First Three Months of 2005

Net income for the first three months of 2006 was $538,000 compared to $1,041,000 for the same period of 2005, representing a 48% decrease. The decrease was the result of a significant increase in professional and legal costs, approximately $175,000. A majority of the increase in professional and legal costs is associated with the treasury stock purchase previouly described. In addition the 2005 first quarter included a $470,000 credit (benefit) to the loan loss provision in contrast to the $30,000 expense in 2006. Net interest income was $ 93,000 lower in 2006 compared to 2005.

Interest income for the three months ended March 31, 2006 was $4.1 million, an increase of 1.85% from interest income of $4.0 million for the three months ended March 31, 2005. The yield on the loan portfolio for the first three months of 2006 increased fifteen (15) basis points to 5.77%. The bank has been able to book higher yielding loans; in addition, loans tied to prime are earning higher yields than last year. The yield on the securities portfolio for the first three months of 2006 decreased fifteen (15) basis points to 5.38%. The yield decreased due to the maturities and prepayments of higher earning securities throughout the prior year. The yield on total average earning assets for the first three months of 2006 increased seven (7) basis points from 2005 to 5.66%.

Total interest expense of $1.2 million for the first three months of 2006 increased by $169,000 or 16.32% from the first three months of 2005. In the first quarter of 2006, the market cost of interest bearing depoisits increased, in addition the volume of the Corporations interest bearing deposits increased compared to 2005. The average cost of interest-bearing depoisits for the first three months of 2006 was 2.31%, a thirty-six (36) basis points increase from the same period in 2005.

As a result of the foregoing, net interest income for the first three months of 2006 was $2.9 million, a decrease of $93,000, or 3.16% from net interest income for the same period in 2005. In the first quarter of 2006, the cost of deposits increased slightly faster than the increase in yields on loans and securities, resulting in lower net interest income compared to first quarter 2005. The Corporation may experience more interest margin tightening for the remaining months of 2006, however recent increases in longer-term rates should result in higher yields on loans and securities.

The Corporation recorded a provision for loan losses of $30,000 for the three months ended March 31, 2006 compared to a $470,000 credit to the provision for the three months ended March 31, 2005. The credit in 2005 was determined based upon the information previously provided in Note 2 of the Notes to Consolidated Financial Statements.

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

Non-interest income for the first three months of 2006 was $746,000, an increase of 4.29% from 2005 to 2006. This increase in income of $30,000 is due to additional overdraft fees and higher debit card fees partially offset by lower ATM fees and lower check book sales.

Non-interest expense for the first three months of 2006 reached $2.90 million, an increase of $140,000 or 5.13% from non-interest expense for the first three months of 2005. Personnel costs declined by $73,000, or 5.3% from period to period. This decline is attributed to lower employee benefit costs. Legal and Professional expense increased by $175,000, mainly due to costs associated with the repurchase of stock. In 2006 occupancy cost increased $19,000 due to an increase in maintenance costs compared to the first quarter 2005.

Federal income tax for the first three months of 2006 was $195,000 compared to $395,000 for the same period in 2005. The effective tax rates for the first three months of 2006 and 2005 were 26.64% and 27.51%, respectively.

LIQUIDITY

Liquidity measurements evaluate the Corporation's ability to meet the cash flow requirements of its depositors and borrowers. The most desirable source of liquidity is deposit growth. Additional liquidity is provided by the maturity of investments in loans and securities and the principal and interest received from those earning assets. Another source of liquidity is represented by the Corporation's ability to sell both loans and securities. The Bank is a member of the Federal Home Loan Bank (FHLB) system. The FHLB provides an additional source for liquidity for long- and short-term funding. Additional sources of funding from financial institutions have been established for short-term funding needs.

The statement of cash flows indicates cash from federal funds sold and securities, along with cash from deposit growth was used to fund the treasury stock purchase, in addition to funding loan growth.

As of March 31, 2006, the Corporation had available funding of approximately $175 million at the FHLB, with an additional $30 million of short term funding available through other lines of credit.

OFF BALANCE SHEET ARRANGEMENTS

The Corporation's financial statements do not reflect off balance sheet arrangements that consist of commitments to purchase securities or commitments to extend credit. The Corporation has entered agreements to purchase mortgage-backed securities, with settlement dates in May, June, July and August of 2006. The original face amount for each agreement is $10 million, all will be purchased at a discount, with total commitment to purchase at $ 39.7 million. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral, if any, which the Corporation obtains from the customer upon extension of credit, is based on management's credit evaluation of the customer or other obligor. The types of collateral obtained by the Corporation may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Standby letters of credit, financial standby letters of credit and commercial letters of credit written are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

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

The following table identifies the Corporation's commitments to extend credit and obligations under letters of credit as of March 31, 2006.

	TOTAL AMOUNT COMMITTED
Financial instruments whose contractual amounts represent credit risk:	
Commitments to extend credit	$41,874
Standby letters of credit	399
Financial standby letters of credit	3,742

CREDIT QUALITY RISK

The following table presents a comparison of loan quality as of March 31, 2006 with that as of March 31, 2005. Cash payments received on non-accrual loans are recognized as interest income as long as the remaining balance of the loan is deemed to be fully collectible. When doubt exists as to the collectibility of a loan in non-accrual status, any payments received are applied to principal to the extent the doubt is eliminated. Once a loan is placed on non-accrual status, any unpaid interest is charged against income.

At March 31,		2006		2005
Non-performing loans:				
Loans on non-accrual basis	$	1,246	$	1,534
Past due loans > 90 days		-		-
Renegotiated loans		2,855		3,055
Total non-performing loans		4,101		4,589
Foreclosed real estate		740		686
Total non-performing assets	$	4,841	$	5,275
Loans outstanding at end of period	$	213,510	$	194,315
Average loans outstanding (year-to-date)	$	208,284	$	193,039
Non-performing loans as a percent of total loans		1.92%		2.36%
Provision/(credit) for loan losses	$	30	$	(470)
Net charge-offs (recoveries)	$	39	$	(261)
Net charge-offs as a percent of average loans		.02%		-
Provision for loan losses as a percent of net charge-offs		77.00%		-
Allowance for loan losses	$	1,627	$	1,646

Allowance for loan losses as a percent of average loans outstanding	0.78%	0.85%

As of March 31, 2006, $1,050,000 of non-accrual loans were paying principal or principal and interest with payments recognized on a cash basis. $2.5 million of the renegotiated loan amount relates to a single borrower. The borrower requested a modification of interest and a period of interest only payments. The request was due to the seasonality of the customers' business. The Corporation has no knowledge of other outstanding loans that present a serious doubt in regard to the borrower's ability to comply with current loan prepayment terms.

17

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAPITAL RESOURCES

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 be weighted according to risk; and (3) the total capital to risk-weighted assets ratio be at least 8.00%; and (4) a minimum 4.00% 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. Banking organizations with supervisory, financial, operational, or managerial weaknesses, as well as organizations that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above minimum levels. Moreover, higher capital ratios may be required for any bank holding company if warranted by its particular circumstances or risk profile. In all cases, bank holding companies should hold capital commensurate with the level and nature of the risks, including the volume and severity of problem loans, to which they are exposed. As of March 31, 2006, the Corporation, under these guidelines, had Tier I and total equity capital to risk weighted assets ratios of 17.72% and 18.53% respectively. The leverage ratio was 11.16%. The bank’s capital position and related ratios are similar to the Corporations amounts listed below.

The table below presents the Corporation's capital position at March 31, 2006
(Dollar amounts in thousands)

	Amount	Percent of Adjusted Assets
Tier I Capital	$ 35,591	17.72%
Tier I Capital Requirement	8,032	4.00
Total Equity Capital	$ 37,218	18.53%
Total Equity Capital Requirement	16,064	8.00
Leverage Capital	$ 35,591	11.16%
Leverage Requirement	12,530	4.00

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Corporation’s primary market risk is interest rate risk. Interest rate risk arises due to timing differences between interest sensitive assets and liabilities. Interest rate management seeks to maintain a balance between consistent income growth and the risk that is created by variations in the ability to reprice deposit and investment categories. The effort to determine the effect of potential interest rate changes normally involves measuring the "gap" between assets (loans and securities) subject to rate fluctuation and liabilities (interest bearing deposits and long-term borrowings) 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 and long-term borrowings are based on contractual maturities, where 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 deposits. Regular savings, NOW and other similar interest bearing demand deposit accounts are subject to immediate withdrawal without penalty. However, based upon historical performance, management considers a certain portion of the accounts to be stable core deposits and therefore are projected to reprice over a variety of time periods.

The Corporation utilizes a computer simulation analysis that projects the impact of changing interest rates on earnings. Simulation modeling projects a baseline net interest income (assuming no changes in interest rate levels) and estimates changes to that baseline resulting from changes in interest rate levels. The Corporation utilizes the results of this model in evaluating its interest rate risk. This model incorporates a number of additional factors. These factors include: (1) the expected exercise of call features on various assets and deposits; (2) the expected rates at which various rate sensitive assets and deposits will reprice; (3) the expected relative movements in different interest rate indexes that are used as the basis for pricing or repricing various assets and deposits; (4) expected changes in administered rates on interest-bearing transaction, savings, money market and time deposit accounts and the expected impact of competition on the pricing or repricing of such accounts; and (5) other factors. Inclusion of these factors in the model is intended to estimate the Corporation’s changes in net interest income resulting from an immediate and sustained parallel shift in interest rates of up 100 basis points (bps), up 200 bps, down 100 bps and down 200 bps. While the Corporation believes this model provides a useful projection of its interest rate risk, the model includes a number of assumptions and predictions that are subject to continual refinement. These assumptions and predictions include inputs to compute baseline net interest income, growth rates and a variety of other factors that are difficult to accurately predict.

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 and interest-bearing liabilities.

ITEM 4. 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-Q, 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 March 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 March 31, 2006.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors as previously disclosed in the Corporations December 31, 2005 Form 10-K, Item 1A.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

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 186,574 shares purchased under this authorization through March 31, 2006. There were no shares repurchased under this program during the quarter ended March 31, 2006.

In March 2006, the Board of Directors authorized the repurchase of 362,113 shares of the Corporation's common stock. These shares are not included in the previously approved stock repurchase program.

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

a. Exhibits

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	Amendment to Articles of Incorporation	Exhibit A to definitive Proxy Statement filed for the special meeting of shareholders held September 18, 1990
3.4	Amendment to Articles of Incorporation	Exhibit A to definitive Proxy Statement filed for the meeting of shareholders held on April 15, 1997
3.6	Amendment to Articles of Incorporation	Exhibit A to definitive Proxy Statement filed for the meeting of shareholders held September 21, 2004
3.8	Amendment to the Bylaws of Registrant	Exhibit 3.8 to Form 10-Q for the quarter 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 year ended December 31, 2003
31.1	Section 302 Certification of Chief Executive Officer	Filed herewith
31.2	Section 302 Certification of Chief Financial Officer	Filed herewith
32.1	Section 1350 Certification of the Chief Executive Officer	Filed herewith
32.2		Filed herewith

Section 1350 Certification of the Chief Financial Officer

17

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, 2006	/s/ Gregg E. Hunter Gregg E. Hunter, Vice Chairman President and Chief Executive Officer
Dated: May 15, 2006	/s/ Thomas D. Watters Thomas D. Watters, Senior Vice President and Chief Financial Officer