

CNB FINANCIAL CORP/PA  
Form 10-Q  
May 09, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2006

or

**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 0-13396

**CNB FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

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

**25-1450605**  
(I.R.S. Employer Identification No.)

**County National Bank**

**1 South Second Street**

**P.O. Box 42**

**Clearfield, Pennsylvania 16830**

(Address of principal executive offices)

**Registrant's telephone number, including area code, (814) 765-9621**

Indicate by check mark 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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes  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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

The number of shares outstanding of the issuer's common stock as of May 5, 2006

COMMON STOCK: \$1.00 PAR VALUE, 8,991,141 SHARES

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**FINANCIAL INFORMATION**

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## CNB FINANCIAL CORPORATION

(Dollars in thousands)

|                                                                                        | (unaudited)<br>March 31,<br>2006 | December 31,<br>2005 |
|----------------------------------------------------------------------------------------|----------------------------------|----------------------|
| <b>ASSETS</b>                                                                          |                                  |                      |
| Cash and due from banks                                                                | \$ 13,226                        | \$ 19,146            |
| Interest bearing deposits with other financial institutions                            | 14,959                           | 23,871               |
| <b>TOTAL CASH AND CASH EQUIVALENTS</b>                                                 | <b>28,185</b>                    | <b>43,017</b>        |
| Securities available for sale                                                          | 163,403                          | 161,897              |
| Loans held for sale                                                                    | 4,547                            | 2,733                |
| Loans                                                                                  | 526,979                          | 511,042              |
| Less: unearned discount                                                                | 377                              | 429                  |
| Less: allowance for loan losses                                                        | 5,769                            | 5,603                |
| <b>NET LOANS</b>                                                                       | <b>520,833</b>                   | <b>505,010</b>       |
| FHLB, FRB and other equity interests                                                   | 4,800                            | 4,789                |
| Premises and equipment, net                                                            | 13,794                           | 13,912               |
| Bank owned life insurance                                                              | 13,964                           | 13,797               |
| Accrued interest receivable and other assets                                           | 7,553                            | 6,869                |
| Mortgage servicing rights                                                              | 413                              | 373                  |
| Goodwill                                                                               | 10,821                           | 10,821               |
| Intangible assets, net                                                                 | 697                              | 800                  |
| <b>TOTAL ASSETS</b>                                                                    | <b>\$ 769,010</b>                | <b>\$ 764,018</b>    |
| <b>LIABILITIES</b>                                                                     |                                  |                      |
| Deposits:                                                                              |                                  |                      |
| Non-interest bearing deposits                                                          | \$ 80,176                        | \$ 80,874            |
| Interest bearing deposits                                                              | 543,583                          | 537,629              |
| <b>TOTAL DEPOSITS</b>                                                                  | <b>623,759</b>                   | <b>618,503</b>       |
| Short-term borrowings                                                                  | 198                              | 2,000                |
| Federal Home Loan Bank advances                                                        | 58,250                           | 58,250               |
| Accrued interest and other liabilities                                                 | 6,499                            | 4,987                |
| Subordinated debentures                                                                | 10,310                           | 10,310               |
| <b>TOTAL LIABILITIES</b>                                                               | <b>699,016</b>                   | <b>694,050</b>       |
| <b>SHAREHOLDERS' EQUITY</b>                                                            |                                  |                      |
| Common stock \$1.00 par value                                                          |                                  |                      |
| Authorized 10,000,000 shares                                                           |                                  |                      |
| Issued 9,233,750 shares                                                                | 9,234                            | 9,234                |
| Additional paid in capital                                                             | 4,015                            | 4,160                |
| Retained earnings                                                                      | 59,612                           | 58,439               |
| Treasury stock, at cost (248,884 shares for Mar 2006, and 209,596 shares for Dec 2005) | (3,602)                          | (3,031)              |
| Accumulated other comprehensive income                                                 | 735                              | 1,166                |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                                                      | <b>69,994</b>                    | <b>69,968</b>        |

TOTAL LIABILITIES & SHAREHOLDERS EQUITY

\$ 769,010

\$ 764,018

**Table of Contents****CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

CNB FINANCIAL CORPORATION

(Dollars in thousands, except per share data)

|                                            | <b>THREE MONTHS ENDED</b> |              |
|--------------------------------------------|---------------------------|--------------|
|                                            | <b>MARCH 31,</b>          |              |
|                                            | <b>2006</b>               | <b>2005</b>  |
| <b>INTEREST AND DIVIDEND INCOME</b>        |                           |              |
| Loans including fees                       | \$ 9,434                  | \$ 7,931     |
| Deposits with other financial institutions | 258                       | 149          |
| Securities:                                |                           |              |
| Taxable                                    | 1,289                     | 1,176        |
| Tax-exempt                                 | 437                       | 468          |
| Dividends                                  | 90                        | 72           |
| <b>TOTAL INTEREST AND DIVIDEND INCOME</b>  | <b>11,508</b>             | <b>9,796</b> |
| <b>INTEREST EXPENSE</b>                    |                           |              |
| Deposits                                   | 3,783                     | 2,871        |
| Borrowed funds                             | 903                       | 659          |
| <b>TOTAL INTEREST EXPENSE</b>              | <b>4,686</b>              | <b>3,530</b> |
| Net interest income                        | 6,822                     | 6,266        |
| Provision for loan losses                  | 365                       | 167          |
| <b>NET INTEREST INCOME AFTER PROVISION</b> | <b>6,457</b>              | <b>6,099</b> |
| <b>OTHER INCOME</b>                        |                           |              |
| Trust & asset management fees              | 255                       | 220          |
| Service charges on deposit accounts        | 956                       | 885          |
| Other service charges and fees             | 149                       | 132          |
| Net security gains                         | 341                       |              |
| Mortgage Servicing Income                  | 54                        | 27           |
| Bank owned life insurance earnings         | 167                       | 181          |
| Wealth Management                          | 114                       | 93           |
| Other                                      | 127                       | (11)         |
| <b>TOTAL OTHER INCOME</b>                  | <b>2,163</b>              | <b>1,527</b> |
| <b>OTHER EXPENSES</b>                      |                           |              |
| Salaries & Benefits                        | 2,668                     | 2,555        |
| Net occupancy expense of premises          | 738                       | 702          |
| Amortization of intangibles                | 103                       | 79           |
| Other                                      | 1,933                     | 1,725        |
| <b>TOTAL OTHER EXPENSES</b>                | <b>5,442</b>              | <b>5,061</b> |
| Income before income taxes                 | 3,178                     | 2,565        |
| Applicable income taxes                    | 747                       | 518          |

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|                                                                         |    |       |    |       |
|-------------------------------------------------------------------------|----|-------|----|-------|
| NET INCOME                                                              | \$ | 2,431 | \$ | 2,047 |
| <b>EARNINGS PER SHARE, BASED ON WEIGHTED AVERAGE SHARES OUTSTANDING</b> |    |       |    |       |
| Net income, basic                                                       | \$ | 0.27  | \$ | 0.22  |
| Net income, diluted                                                     | \$ | 0.27  | \$ | 0.22  |
| <b>DIVIDENDS PER SHARE</b>                                              |    |       |    |       |
| Cash dividends per share                                                | \$ | 0.14  | \$ | 0.13  |

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CNB FINANCIAL CORPORATION

Consolidated Statements of Comprehensive Income (unaudited)

(dollars in thousands)

|                                                                                               | <b>Three Months Ended<br/>March 31,</b> |             |
|-----------------------------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                                               | <b>2006</b>                             | <b>2005</b> |
| Net Income                                                                                    | \$ 2,431                                | \$ 2,047    |
| Other comprehensive income, net of tax                                                        |                                         |             |
| Unrealized gains/(losses) on securities:                                                      |                                         |             |
| Unrealized gains/(losses) arising during the period, net of tax                               | (209)                                   | (1,330)     |
| Reclassification adjustment for accumulated (gains)/losses included in net income, net of tax | (222)                                   |             |
| Other comprehensive loss                                                                      | (431)                                   | (1,330)     |
| Comprehensive income                                                                          | \$ 2,000                                | \$ 717      |



**Table of Contents****CONSOLIDATED STATEMENTS OF CASHFLOWS (unaudited)****CNB FINANCIAL CORPORATION****Consolidated Statements of Cash Flows (unaudited)****(Dollars in thousands)**

|                                                                           | <b>3 Months Ended<br/>March 31</b> |             |
|---------------------------------------------------------------------------|------------------------------------|-------------|
|                                                                           | <b>2006</b>                        | <b>2005</b> |
| <b>Cash flows from operating activities:</b>                              |                                    |             |
| Net Income                                                                | \$ 2,431                           | \$ 2,047    |
| Adjustments to reconcile net income to net cash provided by operations:   |                                    |             |
| Provision for loan losses                                                 | 365                                | 167         |
| Depreciation and amortization                                             | 469                                | 463         |
| Amortization and accretion and deferred loan fees                         | (88)                               | 60          |
| Deferred taxes                                                            | (37)                               | 443         |
| Security gains                                                            | (341)                              |             |
| Gain on sale of loans                                                     | (14)                               | (34)        |
| Net gains on dispositions of premises and equipment and acquired property | (4)                                | (16)        |
| Proceeds from sale of loans                                               | 2,170                              | 2,889       |
| Origination of loans for sale                                             | (4,059)                            | (2,685)     |
| Increase in Bank Owned Life Insurance                                     | (167)                              | (181)       |
| Stock-based compensation expense                                          | 23                                 |             |
| Changes in:                                                               |                                    |             |
| Interest receivable and other assets                                      | (592)                              | (584)       |
| Interest payable and other liabilities                                    | 1,760                              | 287         |
| Net cash provided by operating activities                                 | 1,916                              | 2,856       |
| <b>Cash flows from investing activities:</b>                              |                                    |             |
| Proceeds from maturities of:                                              |                                    |             |
| Securities available for sale                                             | 9,499                              | 9,818       |
| Purchase of securities available for sale                                 | (11,345)                           | (25,058)    |
| Loan origination and payments, net                                        | (16,167)                           | 785         |
| (Purchase) redemption of FHLB, FRB & Other Equity Interests               | (11)                               | 429         |
| Net, purchase of premises and equipment                                   | (199)                              | (735)       |
| Proceeds from the sale of premises and equipment and foreclosed assets    |                                    | 201         |
| Net cash used in investing activities                                     | (18,223)                           | (14,560)    |
| <b>Cash flows from financing activities:</b>                              |                                    |             |
| Net change in:                                                            |                                    |             |
| Checking, money market and savings accounts                               | (1,116)                            | 19,871      |
| Certificates of deposit                                                   | 6,372                              | (14,456)    |
| Treasury stock purchased                                                  | (934)                              | (306)       |
| Proceeds from sale of treasury stock                                      | 213                                | 349         |
| Cash dividends paid                                                       | (1,258)                            | (1,202)     |
| Net advances from short-term borrowings                                   | (1,802)                            |             |
| Net cash provided by financing activities                                 | 1,475                              | 4,256       |
| Net decrease in cash and cash equivalents                                 | (14,832)                           | (7,448)     |
| Cash and cash equivalents at beginning of year                            | 43,017                             | 29,912      |

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|                                                           |           |           |
|-----------------------------------------------------------|-----------|-----------|
| Cash and cash equivalents at end of period                | \$ 28,185 | \$ 22,464 |
| <b>Supplemental disclosures of cash flow information:</b> |           |           |
| Cash paid during the period for:                          |           |           |
| Interest                                                  | \$ 4,662  | \$ 3,456  |
| Income Taxes                                              | \$ 1,650  | \$ 910    |
| <b>Supplemental non cash disclosures:</b>                 |           |           |
| Transfers to other real estate owned                      | \$ 87     | \$ 12     |
| Grant of restricted stock awards from treasury stock      | \$ 160    |           |

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**CNB FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**BASIS OF PRESENTATION**

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (SEC) and in compliance with accounting principles generally accepted in the United States of America. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted.

In the opinion of Management of the registrant, the accompanying consolidated financial statements as of March 31, 2006 and for the three months ended March 31, 2006 and 2005 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the period. The financial performance reported for CNB Financial Corporation (the Corporation) for the three month period ended March 31, 2006 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation's Annual Report to shareholders and Form 10-K for the period ended December 31, 2005.

**STOCK COMPENSATION**

The Corporation has a stock incentive plan for key employees and independent directors. The Stock incentive plan, which is administered by a committee of the Board of Directors, provides for up to 625,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date with 100% vested on the fourth anniversary of the grant. For independent directors, the vesting schedule is one-third of the granted options per year beginning one year after the grant date with 100% vested on the third anniversary of the grant.

*Stock Options*

Prior to January 1, 2006, the Corporation accounted for stock-based compensation expense using the intrinsic value method as set forth in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* and as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. No compensation cost for stock options was reflected in net income in prior years, as all options granted had an exercise price equal to the market price of the underlying common stock at date of grant.

On January 1, 2006, the Corporation adopted SFAS No. 123(R) (revised version of SFAS No. 123) which requires measurement of compensation cost for all stock-based awards based on the grant-date fair value and recognition of compensation cost over the requisite service period of stock-based awards, which is usually the same as the period over which the award vests. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Corporation's valuation methodology used for all options granted for purposes of its footnote disclosures required under SFAS No. 123 subsequent to the Corporation adopting its Stock Incentive Plan in 1999. The fair value of future stock option grants, if any, will also be determined using the Black-Scholes valuation model. The Corporation has adopted SFAS No. 123(R) using the modified prospective method which provides for no retroactive application to prior periods and no cumulative adjustment to equity accounts. It also provides for expense recognition, for both new and existing stock-based awards, as the required services are rendered. SFAS No. 123(R) also amends SFAS No. 95, *Statement of Cash Flows*, and requires tax benefits relating to excess stock-based compensation deductions be presented in the statement of cash flows as financing cash inflows.

On March 29, 2005, the Securities and Exchange Commission (SEC) published Staff Accounting Bulletin No. 107 (SAB 107), which expressed the views of the Staff regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provided the Staff's views regarding the valuation of stock-based payment arrangements for public companies. SAB 107 requires that stock-based compensation be classified in the same expense category as cash compensation. Accordingly, the Corporation has included stock-based compensation expense in salaries and employee benefits in the consolidated statements of income.

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The adoption of SFAS 123(R) had the following effect (as a result of stock options) on reported amounts compared with amounts that would have been reported using the intrinsic value method under previous accounting.

|                            | For the Three Months Ended |                        |                 |
|----------------------------|----------------------------|------------------------|-----------------|
|                            | Using                      | March 31, 2006<br>SFAS |                 |
|                            | Previous                   | 123(R)                 | As              |
| (Dollars in thousands)     | Accounting                 | Adjustment             | Reported        |
| Income before income taxes | \$ 3,196                   | \$ (18)                | \$ 3,178        |
| Income taxes               | 753                        | (6)                    | 747             |
| <b>Net Income</b>          | <b>\$ 2,443</b>            | <b>\$ (12)</b>         | <b>\$ 2,431</b> |
| Basic earnings per share   | \$ 0.27                    | \$                     | \$ 0.27         |
| Diluted earnings per share | 0.27                       |                        | 0.27            |

The following table illustrates the effect (as a result of stock options) on the prior year comparable period net income and earnings per share if expense had been measured using the fair value recognition provisions of SFAS No 123(R).

|                            | For the Three Months Ended |                        |                 |
|----------------------------|----------------------------|------------------------|-----------------|
|                            | As                         | March 31, 2005<br>SFAS | If              |
|                            | Reported                   | Adjustment             | Under           |
| (Dollars in thousands)     | Reported                   | Adjustment             | SFAS 123(R)     |
| Income before income taxes | \$ 2,565                   | \$ (32)                | \$ 2,533        |
| Income taxes               | 518                        | (11)                   | 507             |
| <b>Net Income</b>          | <b>\$ 2,047</b>            | <b>\$ (21)</b>         | <b>\$ 2,026</b> |
| Basic earnings per share   | \$ 0.22                    | \$                     | \$ 0.22         |
| Diluted earnings per share | 0.22                       |                        | 0.22            |

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A summary of the activity for stock options is as follows:

|                                          | Three months ended March 31, 2006 |                                          |                                      |                                                      |
|------------------------------------------|-----------------------------------|------------------------------------------|--------------------------------------|------------------------------------------------------|
|                                          | Shares                            | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Fair<br>Value | Weighted<br>Average<br>Remaining<br>Contractual Life |
| Options outstanding, beginning of period | 268,043                           | \$ 13.14                                 | \$ 2.29                              |                                                      |
| Forfeited                                |                                   |                                          |                                      |                                                      |
| Exercised                                |                                   |                                          |                                      |                                                      |
| Granted                                  |                                   |                                          |                                      |                                                      |
| Options outstanding, end of period       | 268,043                           | \$ 13.14                                 | \$ 2.29                              | 6.5 years                                            |
| Options exercisable, end of period       | 259,135                           | \$ 13.13                                 | \$ 2.30                              | 6.5 years                                            |

No stock options were granted during the three month periods ended March 31, 2006 or 2005.

The aggregate intrinsic value of all options outstanding at March 31, 2006 was \$509,692. The aggregate intrinsic value of all options that were exercisable at March 31, 2006 was \$505,238. There were no options exercised during the quarter ended March 31, 2006.

There is no remaining compensation cost subsequent to March 31, 2006 for stock option awards that have been awarded but not vested.

*Restricted Stock Awards*

On February 14, 2006, the Executive Compensation and Personnel Committee of the Board of Directors granted a total of 11,654 shares of restricted stock to certain key employees and all independent directors of the Corporation. Compensation expense for the restricted stock awards is recognized over the vesting periods noted above based on the fair value of the shares at the date of grant. Unearned restricted stock awards are recorded as a reduction of shareholder's equity until earned. Compensation expense resulting from these restricted stock awards was approximately \$5,300 for the quarter ended March 31, 2006. There was no compensation expense related to restricted stock awards in prior periods.

**Table of Contents****EARNINGS PER SHARE**

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under stock options. For the three month periods ended March 31, 2006 and 2005, 110,500 shares under option were excluded from the diluted earnings per share calculations as they were anti-dilutive.

The computation of basic and diluted EPS is shown below (in thousands except per share data):

|                                                                  | <b>Three months ended<br/>March 31,</b> |             |
|------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                  | <b>2006</b>                             | <b>2005</b> |
| <b>Basic earnings per share computation:</b>                     |                                         |             |
| Net Income                                                       | \$ 2,431                                | \$ 2,047    |
| Gross weighted average shares outstanding                        | 8,987                                   | 9,122       |
| Less: Average unearned restricted stock                          | 6                                       |             |
| Net weighted average shares outstanding                          | 8,981                                   | 9,122       |
| Basic earnings per share:                                        | \$ 0.27                                 | \$ 0.22     |
| <b>Diluted earnings per share computation:</b>                   |                                         |             |
| Net Income                                                       | \$ 2,431                                | \$ 2,047    |
| Weighted average shares outstanding for basic earnings per share | 8,981                                   | 9,122       |
| Add: Dilutive effects of assumed exercises of stock options      | 25                                      | 50          |
| Weighted average shares and potentially dilutive shares          | 9,006                                   | 9,172       |
| Diluted earnings per share                                       | \$ 0.27                                 | \$ 0.22     |

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**SECURITIES**

Securities at March 31, 2006 and December 31, 2005 (in thousands) are as follows:

|                                                  | March 31, 2006<br>Unrealized |          |            | Fair<br>Value | December 31, 2005<br>Unrealized |          |            | Fair<br>Value |
|--------------------------------------------------|------------------------------|----------|------------|---------------|---------------------------------|----------|------------|---------------|
|                                                  | Amortized<br>Cost            | Gains    | Losses     |               | Amortized<br>Cost               | Gains    | Losses     |               |
| Securities available for sale:                   |                              |          |            |               |                                 |          |            |               |
| U.S. Treasury                                    | \$ 11,964                    | \$       | \$ (106)   | \$ 11,858     | \$ 11,961                       | \$       | \$ (111)   | \$ 11,850     |
| U.S. Government agencies and corporations        | 27,348                       |          | (403)      | 26,945        | 31,378                          | 6        | (415)      | 30,969        |
| Obligations of States and Political Subdivisions | 37,344                       | 929      | (88)       | 38,185        | 39,352                          | 1,340    | (20)       | 40,672        |
| Mortgage-backed                                  | 47,424                       | 41       | (633)      | 46,832        | 39,907                          | 71       | (551)      | 39,427        |
| Corporate notes and bonds                        | 29,817                       | 609      | (120)      | 30,306        | 29,820                          | 815      | (187)      | 30,448        |
| Marketable equity securities                     | 8,376                        | 988      | (87)       | 9,277         | 7,688                           | 986      | (143)      | 8,531         |
| Total Securities available for sale              | \$ 162,273                   | \$ 2,567 | \$ (1,437) | \$ 163,403    | \$ 160,106                      | \$ 3,218 | \$ (1,427) | \$ 161,897    |

At March 31, 2006, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

Securities with unrealized losses at March 31, 2006, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

| March 31, 2006                                   | Less than 12 Months |                    | 12 Months or More |                    | Total         |                    |
|--------------------------------------------------|---------------------|--------------------|-------------------|--------------------|---------------|--------------------|
| Description of Securities                        | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| U.S. Treasury                                    | \$ 4,916            | \$ (44)            | \$ 6,942          | \$ (62)            | \$ 11,858     | \$ (106)           |
| U.S. Gov t Agencies & Corps                      | 11,872              | (111)              | 14,195            | (292)              | 26,067        | (403)              |
| Obligations of States and Political Subdivisions | 3,843               | (51)               | 2,229             | (37)               | 6,072         | (88)               |
| Mortgage-Backed                                  | 18,273              | (40)               | 24,162            | (593)              | 42,435        | (633)              |
| Corporate Notes and Bonds                        | 5,901               | (28)               | 7,330             | (92)               | 13,231        | (120)              |
| Marketable Equities                              | 862                 | (27)               | 270               | (60)               | 1,132         | (87)               |
|                                                  | \$ 45,667           | \$ (301)           | \$ 55,128         | \$ (1,136)         | \$ 100,795    | \$ (1,437)         |

| December 31, 2005                                | Less than 12 Months |                    | 12 Months or More |                    | Total         |                    |
|--------------------------------------------------|---------------------|--------------------|-------------------|--------------------|---------------|--------------------|
| Description of Securities                        | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| U.S. Treasury                                    | \$ 4,940            | \$ (39)            | \$ 5,935          | \$ (72)            | \$ 10,875     | \$ (111)           |
| U.S. Gov t Agencies & Corps                      | 11,056              | (127)              | 16,198            | (288)              | 27,254        | (415)              |
| Obligations of States and Political Subdivisions | 3,268               | (16)               | 705               | (4)                | 3,973         | (20)               |
| Mortgage-Backed                                  | 19,548              | (356)              | 9,789             | (195)              | 29,337        | (551)              |
| Corporate Notes and Bonds                        | 8,906               | (70)               | 4,258             | (117)              | 13,164        | (187)              |
| Marketable Equities                              | 1,036               | (43)               | 1,390             | (100)              | 2,426         | (143)              |

|           |          |           |          |           |            |
|-----------|----------|-----------|----------|-----------|------------|
| \$ 48,754 | \$ (651) | \$ 38,275 | \$ (776) | \$ 87,029 | \$ (1,427) |
|-----------|----------|-----------|----------|-----------|------------|

The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation. Consideration is given to the length of time and extent to which fair value has been less than cost, the financial condition and near term prospects of the issuer, and the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Corporation may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The following comments relate to those securities which have been in a continuous unrealized loss position for more than twelve months.

Included in the \$1,136,000 of unrealized losses at March 31, 2006 on investment securities that have been in a continuous unrealized loss position for 12 months or more are \$1,076,000 of unrealized losses on debt securities. Management does not believe any of the individual unrealized losses on debt securities represents an other-than-temporary impairment since these losses are primarily attributable to changes in interest rates and the Corporation has both the intent and ability to hold the debt securities to maturity.



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Unrealized losses on equity securities, which compromise the remainder of the \$1,136,000 and amount to \$60,000 were not individually significant and also considered to be temporary in nature.

During the first quarter, the issuer of a financial institution equity security held in the Corporation's available-for-sale portfolio was acquired by another financial institution. As a result of the acquisition, the Corporation received 1.994 shares of the acquiring entities stock in exchange for each share of the equity security that it held. Following current accounting guidance in FAS No. 153, *Exchanges of Nonmonetary Assets*, the Corporation recorded a \$341,000 realized gain as a result of the difference between its basis in the equity security it held and the fair market value of the shares it received at the date of the exchange.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

In March 2006, the FASB issued FAS No. 156, *Accounting for Servicing of Financial Assets*. This Statement, which is an amendment to FAS No. 140, will simplify the accounting for servicing assets and liabilities, such as those common with mortgage securitization activities. Specifically, FAS No. 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. FAS No. 156 also clarifies when an obligation to service financial assets should be separately recognized as a servicing asset or a servicing liability, requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable, and permits an entity with a separately recognized servicing asset or servicing liability to choose either of the amortization or fair value methods for subsequent measurement. The provisions of FAS No. 156 are effective as of the beginning of the first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Corporation's results of operations or financial position.

## **SUBSEQUENT EVENT**

On April 18, 2006, the shareholders of the Corporation voted to increase the aggregate number of authorized common shares from 10,000,000 to 50,000,000 as well as approve the change from \$1.00 par value to no par stock. The changes had no effect on the dollar amount of total shareholders equity and simply resulted in a reclassification between the common stock and additional paid in capital line items.

**Table of Contents****CONSOLIDATED YIELD COMPARISONS**

(In thousands)

|                                                                        | March 31, 2006     |                |                       | March 31, 2005     |                |                       |
|------------------------------------------------------------------------|--------------------|----------------|-----------------------|--------------------|----------------|-----------------------|
|                                                                        | Average<br>Balance | Annual<br>Rate | Interest<br>Inc./Exp. | Average<br>Balance | Annual<br>Rate | Interest<br>Inc./Exp. |
| <b>Assets</b>                                                          |                    |                |                       |                    |                |                       |
| Interest-bearing deposits with banks                                   | \$ 7,146           | 5.71%          | \$ 102                | \$ 6,012           | 4.39%          | \$ 66                 |
| Federal funds sold and securities purchased under agreements to resell | 7,763              | 8.04%          | 156                   | 7,972              | 4.16%          | 83                    |
| Securities:                                                            |                    |                |                       |                    |                |                       |
| Taxable (1)                                                            | 113,488            | 4.58%          | 1,289                 | 126,903            | 3.71%          | 1,176                 |
| Tax-Exempt (1,2)                                                       | 37,605             | 6.59%          | 615                   | 39,089             | 6.63%          | 648                   |
| Equity Securities (1,2)                                                | 12,910             | 3.50%          | 111                   | 12,252             | 2.91%          | 89                    |
| Total Securities                                                       | 178,912            | 5.59%          | 2,273                 | 192,228            | 4.29%          | 2,062                 |
| <b>Loans</b>                                                           |                    |                |                       |                    |                |                       |
| Commercial (2)                                                         | 198,245            | 7.43%          | 3,680                 | 184,270            | 6.61%          | 3,045                 |
| Mortgage (2)                                                           | 293,541            | 6.95%          | 5,102                 | 265,535            | 6.59%          | 4,377                 |
| Installment                                                            | 28,061             | 10.81%         | 758                   | 27,828             | 8.81%          | 613                   |
| Leasing                                                                | 502                | 5.58%          | 7                     | 1,740              | 6.21%          | 27                    |
| Total Loans (3)                                                        | 520,349            | 7.34%          | 9,547                 | 479,373            | 6.73%          | 8,062                 |
| Total earning assets                                                   | 699,261            | 6.76%          | 11,820                | 671,601            | 6.03%          | 10,124                |
| <b>Non Interest Bearing Assets</b>                                     |                    |                |                       |                    |                |                       |
| Cash & Due From Banks                                                  | 16,746             |                |                       | 16,774             |                |                       |
| Premises & Equipment                                                   | 13,804             |                |                       | 14,184             |                |                       |
| Other Assets                                                           | 36,904             |                |                       | 39,405             |                |                       |
| Allowance for Loan Losses                                              | (5,710)            |                |                       | (5,586)            |                |                       |
| Total Non Interest Earning Assets                                      | 61,744             |                |                       | 64,777             |                |                       |
| <b>Total Assets</b>                                                    | <b>\$ 761,005</b>  |                | <b>\$ 11,820</b>      | <b>\$ 736,378</b>  |                | <b>\$ 10,124</b>      |
| <b>Liabilities and Shareholders Equity</b>                             |                    |                |                       |                    |                |                       |
| <b>Interest-Bearing Deposits</b>                                       |                    |                |                       |                    |                |                       |
| Demand - interest-bearing                                              | \$ 139,334         | 1.09%          | \$ 381                | \$ 147,964         | 0.58%          | \$ 214                |
| Savings                                                                | 64,211             | 0.57%          | 92                    | 74,135             | 0.60%          | 111                   |
| Time                                                                   | 333,155            | 3.97%          | 3,310                 | 312,696            | 3.26%          | 2,546                 |
| Total interest-bearing deposits                                        | 536,700            | 2.82%          | 3,783                 | 534,795            | 2.15%          | 2,871                 |
| Short-term borrowings                                                  | 1,237              | 3.56%          | 11                    | 2,000              | 1.20%          | 6                     |
| Long-term borrowings                                                   | 58,250             | 4.75%          | 692                   | 40,000             | 5.02%          | 502                   |
| Trust preferred securities                                             | 10,310             | 7.76%          | 200                   | 10,310             | 5.86%          | 151                   |
| Total interest-bearing liabilities                                     | 606,497            | 3.09%          | 4,686                 | 587,105            | 2.41%          | 3,530                 |
| Demand - non-interest-bearing                                          | 78,317             |                |                       | 72,363             |                |                       |
| Other liabilities                                                      | 6,100              |                |                       | 7,808              |                |                       |
| Total Liabilities                                                      | 690,914            |                | 4,686                 | 667,276            |                | 3,530                 |
| Shareholders Equity                                                    | 70,091             |                |                       | 69,102             |                |                       |
| <b>Total Liabilities and Shareholders Equity</b>                       | <b>\$ 761,005</b>  |                | <b>\$ 4,686</b>       | <b>\$ 736,378</b>  |                | <b>\$ 3,530</b>       |

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|                                               |              |                 |              |                 |
|-----------------------------------------------|--------------|-----------------|--------------|-----------------|
| Interest Income/Earning Assets                | 6.76%        | \$ 11,820       | 6.03%        | \$ 10,124       |
| Interest Expense/Interest Bearing Liabilities | 3.09%        | 4,686           | 2.41%        | 3,530           |
| <b>Net Interest Spread</b>                    | <b>3.67%</b> | <b>\$ 7,134</b> | <b>3.62%</b> | <b>\$ 6,594</b> |
| Interest Income/Interest Earning Assets       | 6.76%        | \$ 11,820       | 6.03%        | \$ 10,124       |
| Interest Expense/Interest Earning Assets      | 2.68%        | 4,686           | 2.10%        | 3,530           |
| <b>Net Interest Margin</b>                    | <b>4.08%</b> | <b>\$ 7,134</b> | <b>3.93%</b> | <b>\$ 6,594</b> |

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- (1) Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields are stated on a fully taxable equivalent basis.
- (3) Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the average of total loans less average unearned income. The amount of loan fees included in the interest income on loans is not material.

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**ITEM 2**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

The following discussion and analysis of the consolidated financial statements of CNB Financial Corporation (the Corporation) is presented to provide insight into management's assessment of financial results. The Corporation's primary subsidiary, County National Bank (the Bank), provides financial services to individuals and businesses within the Bank's market area which is primarily made up of the west central Pennsylvania counties of Cambria, Clearfield, Centre, Elk, Jefferson and McKean. During 2005 the Bank entered the northwestern Pennsylvania county of Erie and began doing business as ERIEBANK. The Bank is a member of the Federal Reserve System and subject to regulation, supervision and examination by the Office of the Comptroller of the Currency (OCC). The financial condition and results of operations are not intended to be indicative of future performance. Two of the Corporation's subsidiaries, CNB Investment Corporation and CNB Securities Corporation, are incorporated in Delaware and currently maintain investments in debt and equity securities. County Reinsurance Company, also a subsidiary, is a Corporation of Arizona, and provides credit life and disability for customers of County National Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Finally, Holiday Financial Services Corporation, incorporated in Pennsylvania, was formed in the fourth quarter of 2005 to facilitate the Corporation's entry into the consumer discount loan and finance business. Management's discussion and analysis should be read in conjunction with the consolidated financial statements and related notes.

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents totaled \$28,185,000 at March 31, 2006 compared to \$43,017,000 on December 31, 2005. The reduction in cash was primarily used to fund loan growth that occurred during the first quarter.

Management believes the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Corporation to meet cash obligations and off-balance sheet commitments as they come due.

**SECURITIES**

Securities increased approximately \$1,506,000 or 0.9% since December 31, 2005. The slight increase is primarily the result of purchases made in short duration fixed and variable collateralized mortgage obligations. The purchase of these short duration investments is part of an overall corporate strategy to use normal run-off of the investment portfolio to fund anticipated loan growth during the latter part of 2006. This strategy is intended to provide an improved net interest margin as we increase the yield on earning assets while managing our investment portfolio to a level that will still maintain appropriate levels of liquidity within the balance sheet.

The Corporation generally buys into the market over time and does not attempt to time its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and minimize the overall effect of different rate environments. Management monitors the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through Asset / Liability Committee (ALCO) meetings. The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, the Corporation maintains sufficient liquidity to satisfy depositor requirements and various credit needs of its customers.

**LOANS**

The Corporation's lending is primarily focused on the west central Pennsylvania market and consists principally of commercial lending primarily to locally owned small businesses and retail lending which includes single-family residential mortgages and other consumer lending. At March 31, 2006, the Corporation had \$526,602,000 in loans outstanding, net of unearned discount, an increase of \$15,989,000 (or 3.1%) since December 31, 2005. The increase was primarily the result of demand for our commercial loan products including commercial mortgages. The Corporation sees commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced lenders and supporting them with quality credit analysis. During the third quarter of 2005 the Corporation opened a loan production office (LPO) in Erie, Pennsylvania as part of the

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previously mentioned ERIEBANK project. At March 31, 2006, the Erie LPO had generated \$6,229,000 in loans outstanding.

**ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged-off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance.

The table below shows activity within the allowance account:

| (\$'s in thousands)              | March 31, 2006 | Periods Ending<br>Dec. 31, 2005 | March 31, 2005 |
|----------------------------------|----------------|---------------------------------|----------------|
| Balance at beginning of Period   | \$ 5,603       | \$ 5,585                        | \$ 5,585       |
| Charge-offs:                     |                |                                 |                |
| Commercial and financial         |                | 16                              | 1              |
| Commercial mortgages             | 25             | 135                             | 42             |
| Residential mortgages            | 36             | 152                             | 40             |
| Installments                     | 131            | 372                             | 97             |
| Lease receivables                | 14             |                                 |                |
| Overdrafts                       | 64             | 300                             | 62             |
|                                  | 270            | 975                             | 242            |
| Recoveries                       |                |                                 |                |
| Commercial and financial         | 1              | 1                               |                |
| Commercial mortgages             |                | 18                              | 18             |
| Residential mortgages            |                |                                 |                |
| Installments                     | 22             | 99                              | 26             |
| Lease receivables                | 3              | 1                               | 1              |
| Overdrafts                       | 45             | 91                              | 32             |
|                                  | 71             | 210                             | 77             |
| Net charge-offs:                 | (199)          | (765)                           | (165)          |
| Provision for loan losses        | 365            | 783                             | 167            |
| Balance at end-of-period         | \$ 5,769       | \$ 5,603                        | \$ 5,587       |
| Loans, net of Unearned           | \$ 526,602     | \$ 510,613                      | \$ 481,074     |
| Allowance to net loans           | 1.10%          | 1.10%                           | 1.16%          |
| Net charge-offs to average loans | 0.15%          | 0.15%                           | 0.13%          |
| Non performing assets            | \$ 2,597       | \$ 2,180                        | \$ 2,933       |
| Non performing % of total assets | 0.34%          | 0.28%                           | 0.40%          |

The adequacy of the allowance for loan and lease losses is subject to a formal analysis by the credit administrator of the Bank. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First is a selection of criticized loans that is given a specific reserve. The remaining loans are pooled, by category, into these segments: Reviewed

Commercial and financial

Commercial mortgages

Homogeneous

Residential real estate

Installment

Lease receivables

Credit cards

Overdrafts

The reviewed loan pools are further segregated into three categories: substandard, doubtful and unclassified. Historical loss factors are calculated for each pool excluding overdrafts based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous quarter end and the two most recent year ends. The historical loss factors for both the reviewed and homogeneous pools are adjusted based on these six qualitative factors:

Levels of and trends in delinquencies and non-accruals

Trends in volume and terms of loans

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Effects of any changes in lending policies and procedures

Experience, ability and depth of management

National and local economic trends and conditions

Concentrations of credit

The methodology described above was created using the experience of our credit administrator, guidance from the regulatory agencies, expertise of our loan review partner, and discussions with our peers. The resulting factors are applied to the pool balances in order to estimate the inherent risk of loss within each pool.

The allowance coverage of net loans as well as the annualized net charge-offs to average loans has remained relatively flat and in a favorable range since December 31, 2005. Through the analysis methodology detailed above, the coverage during the period was considered appropriate and adequate based on the Corporation's current risk profile. The adequacy of the allowance for loan losses is subject to a formal analysis by an independent loan review analyst, as well as our internal credit administrator, and is deemed to be adequate to absorb probable incurred losses in the portfolio as of March 31, 2006.

**FUNDING SOURCES**

The Corporation considers deposits, short-term borrowings, and term debt when evaluating funding sources. Traditional deposits continue to be the main source of funds in the Corporation, reaching \$623,759,000 at March 31, 2006. Deposits have increased only 0.85% since year-end 2005. As mentioned in the Securities section of this analysis, the Corporation plans to utilize normal investment run-off to fund projected loan growth and does not plan to aggressively grow deposits or seek outside funding sources during 2006. Furthermore, we will continue to implement strategies to manage our cost of funds by shifting a larger percentage of our deposit dollars into lower interest bearing transaction type deposits throughout 2006.

Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank (FHLB) to meet funding needs not accommodated by deposit growth. There were no new borrowings during the quarter ended March 31, 2006, however, management plans to maintain access to short and long-term FHLB borrowings as an available funding source when deemed appropriate.

**SHAREHOLDERS EQUITY**

The Corporation's capital continues to provide a base for profitable growth. Total shareholders' equity was \$69,994,000 at March 31, 2006 compared to \$69,968,000 at December 31, 2005, an increase of \$26,000. In the first three months of 2006, the Corporation earned \$2,431,000 and declared dividends of \$1,258,000, a dividend payout ratio of 51.7% of net income. This growth was offset by the purchase of treasury stock and a decline in the securities market value as discussed below.

During the first three months of 2006, the Corporation continued to repurchase shares of its own stock under a publicly announced plan. This strategy is the primary reason for the increase in treasury stock of 39,288 shares or \$571,000 since December 31, 2005.

The securities in the Corporation's portfolio are classified as available for sale making the Corporation's balance sheet more sensitive to the changing market value of investments. The Federal Open Market Committee raised the federal discount rate by 50 basis points in the first three months of 2006. This situation affected the market value of various securities in the Corporation's portfolio and is the primary reason for a decrease in accumulated other comprehensive income, included in shareholders' equity, of \$431,000 since December 31, 2005.

The Corporation has also complied with the standards of capital adequacy mandated by the banking regulators. Bank regulators have established risk-based capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets banks hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets), is assigned to each asset on the balance sheet. The Corporation's total risk-based capital ratio of 12.47% at March 31, 2006 is above the well-capitalized standard of 10%. The Corporation's Tier 1 capital ratio of 11.44% is above the well-capitalized minimum of 6%. The leverage ratio at March 31, 2006 was 9.26%, also above the well-capitalized standard of 5%. The Corporation is well capitalized as measured by the federal regulatory agencies. The ratios provide quantitative data demonstrating the strength and future opportunities for use of the Corporation's capital base. Management continues to

evaluate risk-based capital ratios and the capital position of the Corporation as part of its strategic decision making process.



**Table of Contents****LIQUIDITY AND INTEREST RATE SENSITIVITY**

Liquidity measures an organizations ability to meet cash obligations as they come due. The Consolidated Statement of Cash Flows presented on page 6 of the accompanying unaudited financial statements provides analysis of the Corporation s cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year as part of the Corporation s liquid assets. The Corporation s liquidity is monitored by the ALCO Committee, which establishes and monitors ranges of acceptable liquidity. Management feels the Corporation s current liquidity and interest rate position is acceptable.

**OFF BALANCE SHEET ACTIVITIES**

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. The contractual amount of financial instruments with off-balance sheet risk was as follows at March 31, 2006:

|                              |                   |
|------------------------------|-------------------|
| Commitments to extend credit | \$ 146,075        |
| Standby letters of credit    | 14,593            |
|                              | <b>\$ 160,668</b> |

**RESULTS OF OPERATIONS****OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$2,431,000 for the first quarter of 2006 compared to \$2,047,000 for the same period of 2005. The earnings per diluted share increased from \$0.22 in the first 3 months of 2005 to \$0.27 for the first 3 months of 2006. The return on assets and the return on equity for the three months of 2006 are 1.30% and 14.28% as compared to 1.15% and 12.56% for the first three months of 2005.

**INTEREST INCOME AND EXPENSE**

Net interest income totaled \$6,822,000 in the first quarter, an increase of \$556,000 (or 8.9%) over the first quarter of 2005. Total interest and dividend income increased by \$1,712,000 (or 17.5%) as compared to the first quarter of 2005 while total interest expense increased \$1,156,000 (or 32.7%) as compared to the first quarter of 2005. The primary reason for the growth in net interest income stems from an improved level of average earning assets and increasing yields. As noted on page 13 of this analysis, the Corporation s average earning assets have increased by \$27,660,000 from \$671,601,000 for the three months ended March 31, 2005 to \$699,261,000 for the three months ended March 31, 2006 while our fully tax equivalent net interest margin increased from 3.93% to 4.08%.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$365,000 in the first quarter of 2006 compared to \$167,000 in the first quarter of 2005. As noted in the allowance for loan loss table on page 15, the Corporation has experienced a consistent and relatively low level of charge-offs over the past several years. In addition, based on management s detailed evaluation of problem loans, criticized assets, charge-offs and the overall effects of the economy in our markets, it appears that the credit quality of our existing assets has improved slightly and management believes the first quarter provision is reasonable and adequate. Although credit quality has improved slightly, the provision is higher in the first quarter of 2006 because of loan growth. Loan balances actually decreased slightly during the first quarter of 2005. Management believes the allowance provides coverage of our current loan balances and is adequate to absorb probable incurred losses in our portfolio as of March 31, 2006.

**OTHER INCOME**

Other income increased \$636,000 (or 40.3%) in the first quarter of 2006 as compared to the same period in 2005. Almost 54% (or \$341,000) of the \$636,000 increase relates to a security gain. During the first quarter, the issuer of a financial institution equity security held in the Corporation s available-for-sale portfolio was acquired by another financial institution. As a result of the acquisition, the Corporation received 1.994 shares of the acquiring entities stock in exchange for each share of the equity security that it held. Following current accounting guidance in FAS No. 153, *Exchanges of Nonmonetary Assets*, the Corporation recorded a \$341,000 realized gain as a result of the difference between its basis in the equity security it held and the fair market value of the shares it received at the date of the exchange.



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The Corporation is also seeing positive trends in other line items such as trust and asset management, service charges on deposits, and fees from wealth management services. A positive enhancement to our other non interest income line has been revenue from increased transactions on our Visa Check Card product as well as increased credit card merchant services which accounted for the majority of the increase in the other category as it increased by \$185,000 over the same period in 2005. It should be noted, however, that approximately 27% of the increase relates to the fact that in the first quarter of 2005 the other non interest income line reflected approximately \$50,000 of loss on disposal of fixed assets related to the relocation of a branch.

### **OTHER EXPENSE**

Non-interest expense increased by 7.5% to \$5,491,000 in the first quarter of 2006 compared to \$5,110,000 in the first quarter of 2005. The majority (approximately 76%) of the increase was a result of the Corporation increasing costs for salaries as well as technology. Like many growing entities, the Corporation is faced with increasing employee related costs to attract and retain quality personnel to support its growth. Likewise, current investments in technology and technology-related costs are also considered to be critical to the future success of the Corporation. As such, the Corporation will strive to manage expenses while recognizing some, such as increasing costs for salaries, occupancy, outside services and technology, are simply the result of continued growth. As mentioned in the future outlook section of this analysis, the Corporation is beginning the process of expanding its banking franchise into the Erie, Pennsylvania market as well as opening three new offices of its consumer finance subsidiary Holiday Financial Services Corporation. The Corporation realizes that expenses related to these new ventures may outpace related revenues in the near term but believes the long-term growth potential is more than worth the near term cost.

### **FEDERAL INCOME TAX EXPENSE**

Federal income tax expense was \$747,000 in the first quarter of 2006 as compared to \$518,000 in the first quarter of 2005 resulting in an effective tax rate of 23.5% and 20.2%, respectively. The effective tax rate for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

### **FUTURE OUTLOOK**

During 2005, the Bank established a loan production office in Erie, Pennsylvania in order to begin offering commercial loan service to businesses located within Erie and Erie County. Before the end of the third quarter management plans to have a full service branch open in Erie as we begin the process of growing our ERIEBANK franchise. Erie, along with our traditional market areas, should provide the Bank with good loan growth in 2006.

As mentioned in the funding and securities sections of this analysis, the Corporation anticipates using normal runoff of the investment portfolio to fund expected loan growth. This strategy is intended to provide a better net interest margin as we increase the yield on earning assets while managing the investments to a level that will still maintain appropriate levels of liquidity within the balance sheet. Management believes this strategy will improve overall earnings but will slow the growth in assets as we will not aggressively seek outside funding. Our current forecast projects minimal growth in total assets.

Non-interest income should be enhanced in several areas including improved trust fees and wealth management fees. A known area of increased costs will be the personnel and occupancy costs related to the 2006 opening of a full-service branch in Warren, Pennsylvania as well as the previously mentioned growth plans for our ERIEBANK division. In addition, we will open three new offices of our consumer finance venture, Holiday Financial Services Corporation in the communities of Hollidaysburg, Northern Cambria and Clearfield, Pennsylvania. While noninterest costs are expected to increase with the opening of these offices, they should provide sustained growth in earning assets to help offset these costs into the future.

Management concentrates on return on average equity and earnings per share evaluations, plus other methods to measure and direct the performance of the Corporation. While past results are not an indication of future earnings, we feel the Corporation is positioned to enhance performance of normal operations through 2006.

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**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of CNB Financial Corporation are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the financial services industry. Accounting and reporting practices for the allowance for loan losses and fair value of securities are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those used by management could result in material changes in CNB Financial Corporation's financial position or results of operations. Note 1 (Summary of Significant Accounting Policies), Note 3 (Securities), and Note 5 (Allowance for Loan and Lease Losses), of the 2005 Annual Report and 10-K, provide detail with regard to the Corporation's accounting for the allowance for loan losses and fair value of securities. There have been no significant changes in the application of accounting policies since December 31, 2005.

**SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

Certain statements contained in the report that are not historical facts are forward looking statements that are subject to certain risks and uncertainties. When used herein, the terms anticipates, plans, expects, believes, estimate or projected and similar expressions as they relate to CNB Financial Corporation or its management are intended to identify such forward looking statements. CNB Financial Corporation's actual results, performance or achievements may materially differ from those expressed or implied in the forward-looking statements. Risks and uncertainties that could cause or contribute to such material differences include, but are not limited to, general economic conditions, interest rate environment, competitive conditions in the financial services industry, changes in law, governmental policies and regulations, and rapidly changing technology affecting financial services.

**ITEM 3**

**QUANTITATIVE & QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates, and equity prices. As a financial institution, the Corporation is primarily sensitive to the interest rate risk component. Changes in interest rates will affect the levels of income and expense recorded on a large portion of the Bank's assets and liabilities. Additionally, such fluctuations in interest rates will impact the market value of all interest sensitive assets. The Asset/Liability Committee (ALCO) is responsible for reviewing the interest rate sensitivity position and establishing policies to control exposure to interest rate fluctuations. The primary goal established by this policy is to increase total income within acceptable risk limits.

The corporation monitors interest rate risk through the use of two models: earnings simulation and static gap. Each model standing alone has limitations, however taken together they represent a reasonable view of the Corporation's interest rate risk position. The following discussion provides a summary of our analysis at December 31, 2005 which is the most recent data available at the time of this filing.

*STATIC GAP:* Gap analysis is intended to provide an approximation of projected repricing of assets and liabilities at a point in time on the basis of stated maturities, prepayments, and scheduled interest rate adjustments within selected time intervals. A gap is defined as the difference between the principal amount of assets and liabilities which reprice within those time intervals. The cumulative one year gap at December 31, 2005 was 2.84% of total earning assets compared to policy guidelines of plus or minus 15.0%.

Fixed rate securities, loans and CDs are included in the gap repricing based on time remaining until maturity. Mortgage prepayments are included in the time frame in which they are expected to be received.

Certain shortcomings are inherent in the method of analysis presented in Static Gap. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may not react correspondingly to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate with changes in market interest rates, while interest rates on other types of assets may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features, like annual and lifetime rate caps, which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed in the table. Finally, the ability of certain borrowers to make scheduled payments on their adjustable-rate loans may decrease in the event of an interest rate increase.

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**EARNINGS SIMULATION:** This model forecasts the projected change in net income resulting from an increase or decrease in the level of interest rates. The model assumes a one time shock of plus or minus 200 basis points or 2%.

The model makes various assumptions about cash flows and reinvestments of these cash flows in the different rate environments. Generally, repayments, maturities and calls are assumed to be reinvested in like instruments and no significant change in the balance sheet mix is assumed. Actual results could differ significantly from these estimates which would produce significant differences in the calculated projected change in income. The limits stated above do not necessarily represent measures that would be taken by management in order to stabilize income results. The instruments on the balance sheet do react at different speeds to various changes in interest rates as discussed under Static Gap. In addition, there are strategies available to management that minimize the decline in income caused by a rapid rise in interest rates.

The following table below summarizes the information from the interest rate risk measures reflecting rate sensitive assets to rate sensitive liabilities at December 31, 2005:

|                             |                |
|-----------------------------|----------------|
| Static 1-Yr. Cumulative Gap | <b>2.84%</b>   |
| Earnings Simulation         |                |
| -200 bps vs. Stable Rate    | <b>4.65%</b>   |
| +200 bps vs. Stable Rate    | <b>(2.66)%</b> |

The interest rate sensitivity position at December 31, 2005 was asset sensitive in the short-term. Management measures the potential impact of significant changes in interest rates on both earnings and equity. By the use of computer generated models, the potential impact of these changes has been determined to be acceptable with modest affects on net income and equity given and interest rate shock of an increase or decrease in rates of 2.0%. We continue to monitor the interest rate sensitivity through the ALCO and use the data to make strategic decisions.

**ITEM 4****CONTROLS AND PROCEDURES**

As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of the Corporation's management, including our Chief Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures are, to the best of their knowledge, effective to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Subsequent to the date of their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that there were no significant changes in the Corporation's internal controls or in other factors that could significantly affect its internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS - None**

**ITEM 1A. RISK FACTORS** There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year-ended December 31, 2005.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**  
ISSUER PURCHASES OF EQUITY SECURITIES

| Period            | Total Number<br>of Shares (or<br>Units) | Average<br>Price Paid<br>per<br>Share<br>(or Unit) | Total Number of                                                                               | Maximum Number (or<br>Approximate Dollar<br>Value) of Shares (or<br>Units) that May Yet Be<br>Purchased Under the<br>Plans or Programs |
|-------------------|-----------------------------------------|----------------------------------------------------|-----------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|
|                   |                                         |                                                    | Shares (or Units)<br>Purchased<br>as Part<br>of Publicly<br>Announced<br>Plans<br>or Programs |                                                                                                                                        |
| 1/1/06 to 1/31/06 | 51,144                                  | \$ 14.16                                           | 50,980                                                                                        | 278,745                                                                                                                                |
| 2/1/06 to 2/28/06 | 4,777                                   | 13.99                                              | 4,363                                                                                         | 274,382                                                                                                                                |
| 3/1/06 to 3/31/06 | 10,176                                  | 13.96                                              | 9,869                                                                                         | 264,513                                                                                                                                |
| Total             | 66,097                                  | \$ 14.12                                           | 65,212                                                                                        |                                                                                                                                        |

Purchases not made in conjunction with the Publicly Announced Plan were made to facilitate employee benefit plans in the form of a 401(k).

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES - None****ITEM 4. SUBMISSION OF MATTERS FOR SECURITY HOLDERS VOTE - None****ITEM 5. OTHER INFORMATION - None****ITEM 6. EXHIBITS**

EXHIBIT 31.1 CEO Certification

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EXHIBIT 31.2 Principal Financial Officer Certification

EXHIBIT 32 Certifications

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**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.

CNB FINANCIAL CORPORATION

(Registrant)

DATE: May 9, 2006

/s/ William F. Falger  
William F. Falger  
President and Director

(Principal Executive Officer)

DATE: May 9, 2006

/s/ Charles R. Guarino.  
Charles R. Guarino  
Treasurer

(Principal Financial Officer)