

FIRST NATIONAL COMMUNITY BANCORP INC  
Form 10-Q  
November 09, 2009

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

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 No. 333-24121

FIRST NATIONAL COMMUNITY BANCORP, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania 23-2900790  
(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer  
Identification No.)

102 E. Drinker St., Dunmore, PA 18512  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code (570) 346-7667

\_\_\_\_\_  
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 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  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

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

Large Accelerated Filer  Accelerated Filer

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Non-Accelerated Filer

Smaller reporting company

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

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Common Stock, \$1.25 par value	16,248,570 shares
(Title of Class)	(Outstanding at November 6, 2009)

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FIRST NATIONAL COMMUNITY BANCORP, INC.

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FIRST NATIONAL COMMUNITY BANCORP, INC.  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2009 (UNAUDITED)	December 31, 2008 (AUDITED)
	(dollars in thousands, except share data)	
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$21,418	\$ 18,171
Federal funds sold	74,975	0
Total cash and cash equivalents	96,393	18,171
Securities:		
Available-for-sale, at fair value	248,573	245,900
Held-to-maturity, at cost (fair value \$1,931 on September 30, 2009 and \$1,774 on December 31, 2008)	1,876	1,808
Federal Reserve Bank and FHLB stock, at cost	11,514	11,087
Net loans	945,502	956,674
Bank premises and equipment	17,992	17,785
Intangible Assets	9,953	9,781
Other assets	54,095	52,553
Total Assets	\$1,385,898	\$ 1,313,759
<b>LIABILITIES</b>		
Deposits:		
Demand – non-interest bearing	\$79,335	\$ 79,760
Interest bearing demand	351,613	302,058
Savings	85,764	79,526
Time (\$100,000 and over)	255,577	191,052
Other time	282,933	300,496
Total deposits	1,055,222	952,892
Borrowed funds	207,701	245,197
Subordinated debentures	11,000	0
Other liabilities	9,188	15,328
Total Liabilities	\$1,283,111	\$ 1,213,417
<b>SHAREHOLDERS' EQUITY</b>		
Common Stock, \$1.25 par value, Authorized: 50,000,000 shares		
Issued and outstanding:		
16,248,570 shares at September 30, 2009 and 16,047,928 shares at December 31, 2008	\$ 20,311	\$ 20,060
Additional Paid-in Capital	61,028	59,591
Retained Earnings	33,317	40,892
Accumulated Other Comprehensive Income (Loss)	(11,869 )	(20,201 )
Total shareholders' equity	\$102,787	\$ 100,342
Total Liabilities and Shareholders' Equity	\$1,385,898	\$ 1,313,759

Note: The balance sheet at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See notes to financial statements

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FIRST NATIONAL COMMUNITY BANCORP, INC.  
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(dollars in thousands, except share data)			
<b>Interest Income:</b>				
Loans	\$ 12,589	\$ 14,436	\$ 38,986	\$ 44,465
Investments	3,193	3,696	9,975	11,149
Federal Funds Sold	31	7	44	12
Total interest income	15,813	18,139	49,005	55,626
<b>Interest Expense:</b>				
Deposits	4,450	5,626	12,917	18,525
Subordinated debt	65	0	65	0
Borrowed Funds	1,750	2,379	5,629	7,346
Total interest expense	6,265	8,005	18,611	25,871
Net Interest Income before Loan Loss Provision	9,548	10,134	30,394	29,755
Provision for credit losses	11,050	300	20,760	1,150
Net interest income (loss)	(1,502 )	9,834	9,634	28,605
<b>Other Income:</b>				
Gain on impaired securities	4,912	0	3,939	0
Noncredit related losses on securities not expected to be sold (recognized in other comprehensive income)	(7,311 )	0	(6,720 )	0
Net impairment losses	(2,399 )	0	(2,781 )	0
Service charges	744	812	2,154	2,332
Other Income	691	633	1,938	1,914
<b>Gain / (Loss) on sale of:</b>				
Loans	280	80	1,287	380
Securities	(30 )	312	795	1,025
Other Real Estate	73	488	73	488
Total other income (loss)	(641 )	2,325	3,466	6,139
<b>Other expenses:</b>				
Salaries & benefits	3,104	3,236	9,420	9,459
Occupancy & equipment	1,040	1,009	3,121	3,013
Advertising expense	180	240	660	720
Data processing expense	433	400	1,299	1,235
FDIC assessment	604	223	2,036	484
Bank shares tax	214	158	646	485
Expense of ORE	774	0	812	0
Other	1,695	1,145	4,070	3,512
Total other expenses	8,044	6,411	22,064	18,908
Income (Loss) before income taxes	(10,187 )	5,748	(8,964 )	15,836
Income tax expense (benefit)	(4,003 )	1,421	(3,802 )	3,809
NET INCOME (LOSS)	\$(6,184 )	\$4,327	\$(5,162 )	\$12,027
<b>Basic earnings (loss) per share</b>				
Basic earnings (loss) per share	\$(0.38 )	\$0.27	\$(0.32 )	\$0.76
<b>Diluted earnings (loss) per share</b>				
Diluted earnings (loss) per share	\$(0.37 )	\$0.27	\$(0.31 )	\$0.74

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Weighted average number of basic shares	16,197,941	15,888,360	16,140,834	15,825,238
Weighted average number of diluted shares	16,585,125	16,218,396	16,534,226	16,166,444

See notes to financial statements

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FIRST NATIONAL COMMUNITY BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	For the Nine Months Ended September 30, 2009                  2008 (dollars in thousands)	
<b>INCREASE (DECREASE) IN CASH EQUIVALENTS:</b>		
<b>Cash Flows From Operating Activities:</b>		
Interest Received	\$46,782	\$54,236
Fees & Commissions Received	4,191	4,295
Interest Paid	(19,424 )	(28,327 )
Income Taxes Paid	(1,861 )	(3,151 )
Cash Paid to Suppliers & Employees	(22,212 )	(17,559 )
<b>Net Cash Provided by Operating Activities</b>	<b>\$7,476</b>	<b>\$9,494</b>
<b>Cash Flows from Investing Activities:</b>		
<b>Securities available for sale:</b>		
Proceeds from Maturities	\$500	\$0
Proceeds from Sales prior to maturity	24,117	65,240
Proceeds from Calls prior to maturity	28,615	30,817
Purchases	(42,695 )	(58,386 )
Net Increase in Loans to Customers	(13,405 )	(54,224 )
Capital Expenditures	(1,336 )	(2,526 )
<b>Net Cash Provided/(Used) by Investing Activities</b>	<b>\$(4,204 )</b>	<b>\$(19,079 )</b>
<b>Cash Flows from Financing Activities:</b>		
<b>Net Increase in Demand Deposits, Money Market Demand, NOW Accounts, and Savings Accounts</b>		
	\$55,369	\$37,914
Net Increase/(Decrease) in Certificates of Deposit	46,961	(27,251 )
Proceeds from issuance of Subordinated Debentures	11,000	0
<b>Net Decrease in Borrowed Funds</b>	<b>(37,496 )</b>	<b>(3,111 )</b>
Net Proceeds from Issuance of Common Stock Through Dividend Reinvestment	1,437	2,275
Net Proceeds from Issuance of Common Stock – Stock Option Plans	92	197
Dividends Paid	(2,413 )	(5,220 )
<b>Net Cash Provided/(Used) by Financing Activities</b>	<b>\$74,950</b>	<b>\$4,804</b>
<b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>	<b>\$78,222</b>	<b>\$(4,781 )</b>
<b>Cash &amp; Cash Equivalents at Beginning of Year</b>	<b>\$18,171</b>	<b>\$24,735</b>
<b>CASH &amp; CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$96,393</b>	<b>\$19,954</b>

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CONSOLIDATED STATEMENTS OF CASH FLOW (CONTINUED)  
(UNAUDITED)

	For the Nine Months Ended September 30, 2009                  2008 (dollars in thousands)	
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Income	\$(5,162 )	\$12,027
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Amortization (Accretion), Net	(2,872 )	(2,741 )
Equity in trust	(4 )	(8 )
Depreciation and Amortization	1,356	1,353
Provision for Probable Credit Losses	20,760	1,150
Provision for Deferred Taxes	(168 )	(161 )
Gain on Sale of Loans	(1,287 )	(380 )
Gain on Sale of Investment Securities	(795 )	(1,025 )
Impairment losses on Investment Securities	2,781	0
Gain on Sale of Other Real Estate	(73 )	(488 )
Increase/(Decrease) in Taxes Payable	(5,638 )	73
Decrease in Interest Receivable	649	1,351
Decrease in Interest Payable	(813 )	(2,455 )
Increase in Prepaid Expenses and Other Assets	(1,728 )	(1,209 )
Increase in Accrued Expenses and Other Liabilities	470	2,007
Total Adjustments	\$12,638	\$(2,533 )
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$7,476	\$9,494

See notes to financial statements

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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN  
STOCKHOLDERS' EQUITY  
For The Nine Months Ended September 30, 2009  
(In thousands, except share data)  
(UNAUDITED)

	COMP-REHEN-SIVE INCOME	COMMON SHARES	STOCK AMOUNT	ADD'L PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME/ (LOSS)	TOTAL
BALANCES, DECEMBER 31, 2008		16,047,928	\$20,060	\$59,591	\$40,892	\$ (20,201 )	\$100,342
Comprehensive Income:							
Net loss for the period	(5,162 )				(5,162 )		(5,162 )
Other comprehensive income, net of tax:							
Unrealized gain on securities available-for-sale	12,184						
Noncredit related losses on securities not expected to be sold	(4,369 )						
Reclassification adjustment for gain or loss included in income	517						
Total other comprehensive income, net of tax	8,332					8,332	8,332
Comprehensive Income	3,170						
Issuance of Common Stock –Stock Options Plans		15,500	19	232			251
Issuance of Common Stock through Dividend Reinvestment		185,142	232	1,205			1,437

Cash dividends paid, \$0.15 per share					(2,413 )		(2,413 )
BALANCES, SEPTEMBER 30, 2009	16,248,570	\$20,311	\$61,028	\$33,317	\$	(11,869 )	\$102,787

See notes to financial statements  
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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN  
STOCKHOLDERS' EQUITY  
For The Nine Months Ended September 30, 2008  
(In thousands, except share data)  
(UNAUDITED)

	COMP-REHEN-SIVE INCOME	COMMON SHARES	STOCK AMOUNT	ADD'L PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME/ (LOSS)	TOTAL
BALANCES, DECEMBER 31, 2007		15,746,250	\$ 19,683	\$ 56,490	\$ 33,159	\$ (2,190 )	\$ 107,142
Comprehensive Income:							
Net income for the period	12,027				12,027		12,027
Other comprehensive income, net of tax:							
Unrealized loss on securities available-for-sale, net of deferred income tax benefit of \$10,114	(18,783 )						
Reclassification adjustment for gain or loss included in income, net of deferred income taxes of \$359	666						
Total other comprehensive loss, net of tax	(18,117 )					(18,117 )	(18,117 )
Comprehensive Loss	(6,090 )						
Issuance of Common Stock - Stock Options Awarded		26,314	39	158			197
Issuance of Common Stock through Dividend Reinvestment		183,232	223	2,052			2,275
					(56 )		(56 )

Prior period adjustment							
Cash dividends paid, \$0.33 per share					(5,220 )		(5,220 )
BALANCES, SEPTEMBER 30, 2008	15,955,796	\$ 19,945	\$ 58,700	\$ 39,910	\$ (20,307 )		\$ 98,248

See notes to financial statements  
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FIRST NATIONAL COMMUNITY BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) The accounting and financial reporting policies of First National Community Bancorp, Inc. and its subsidiary conform to U.S. generally accepted accounting principles and to general practice within the banking industry. The consolidated statements of First National Community Bancorp, Inc. and its subsidiary, First National Community Bank (Bank) including its subsidiary, FNCB Realty, Inc. (collectively, Company) were compiled in accordance with the accounting policies set forth in note 1 of Notes to Consolidated Financial Statements in the Company's 2008 Annual Report to Shareholders. All material intercompany accounts and transactions have been eliminated in consolidation. The accompanying interim financial statements are unaudited. In management's opinion, the consolidated financial statements reflect a fair presentation of the consolidated financial position of the Company and subsidiary, and the results of its operations and its cash flows for the interim periods presented, in conformity with U.S. generally accepted accounting principles. Also in the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows at September 30, 2009 and for all periods presented have been made.

These interim financial statements should be read in conjunction with the audited financial statements and footnote disclosures in the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2008.

(2) The following table identifies the related tax effects allocated to each component of other comprehensive income in the Consolidated Statements of Changes in Stockholders' Equity:

	September 30, 2009			September 30, 2008		
	Pre-tax Amount	Tax (Expense) Benefit	(dollars in thousands) Net of Tax Amount	Pre-tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Unrealized gains (losses) on securities:						
Unrealized holding gains (losses) arising during the period	\$18,744	\$(6,560 )	\$12,184	\$(28,897 )	\$10,114	\$(18,783 )
Noncredit related losses on securities not expected to be sold	(6,720 )	2,351	(4,369 )	0	0	0
Less: reclassification adjustment for gain or loss realized in net income	795	(278 )	517	1,025	(359 )	666
Net unrealized gains (losses)	\$12,819	\$(4,487 )	\$8,332	\$27,872	\$9,755	\$(18,117 )
Other comprehensive income (loss)	\$12,819	\$(4,487 )	\$8,332	\$27,872	\$9,755	\$(18,117 )

(3) Basic earnings per share have been computed by dividing net income (the numerator) by the weighted average number of common shares (the denominator) for the period. Such shares amounted to 16,140,834 and 15,825,238 for the periods ending September 30, 2009 and 2008, respectively.

Diluted earnings per share have been computed by dividing net income (the numerator) by the weighted average number of common shares and options outstanding (the denominator) for the period. Such shares amounted to 16,534,226 and 16,166,444 for the periods ending September 30, 2009 and 2008, respectively.

(4) On August 30, 2000, the Corporation's board of directors adopted an Employee Stock Incentive Plan in which options may be granted to key officers and other employees of the Corporation. The aggregate number of shares which may be issued upon exercise of the options under the plan cannot exceed 1,100,000 shares. Options and rights granted under the plan become exercisable six months after the date the options are awarded and expire ten years after the award date.

The board of directors also adopted on August 30, 2000, the Independent Directors Stock Option Plan for members of the corporation's board of directors who are not officers or employees of the corporation or its subsidiaries. The aggregate number of shares issuable under the plan cannot exceed 550,000 shares and are exercisable six months from the date the awards are granted and expire three years after the award date.

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In accordance with current accounting guidance, all options granted have been charged against income at their fair value. Awards granted under the plans vest immediately and the entire expense of the award is recognized in the year of grant.

A summary of the status of the Corporation's stock option plans is presented below:

	Nine months ended September 30,		2008	
	2009	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at the beginning of the period	325,134	\$12.36	360,694	\$11.93
Granted	74,600	10.81	0	
Exercised	(15,500 )	5.97	(31,125 )	6.31
Forfeited	(3,061 )	18.80	(2,061 )	19.72
Outstanding at the end of the period	381,173	12.27	327,508	12.41
Options exercisable at September 30,	381,173	12.27	327,508	12.41
Weighted average fair value of options granted during the period		2.13		---

Information pertaining to options outstanding at September 30, 2009 is as follows:

Range of Exercise Price	Number Outstanding	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$5.19-\$23.13	381,173	5.7 years	\$12.27	381,173	\$12.27

(5) FHLB Stock: As a member of the Federal Home Loan Bank of Pittsburgh ("FHLB"), First National Community Bank is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants. As of September 30, 2009 and December 31, 2008, our FHLB stock totaled \$10.9 and \$10.4 million, respectively.

In December 2008, the FHLB voluntarily suspended dividend payments on its stock, as well as the repurchase of excess stock from members. The FHLB cited a significant reduction in the level of core earnings resulting from lower short-term interest rates, the increased cost of liquidity, and constrained access to the debt markets at attractive rates and maturities as the main reasons for the decision to suspend dividends and the repurchase of excess capital stock. The FHLB last paid a dividend in the third quarter of 2008.

FHLB stock is held as a long-term investment and its value is determined based on the ultimate recoverability of the par value. First National Community Bancorp, Inc. evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB's long-term performance, which includes factors such as the following:

- its operating performance

- the severity and duration of declines in the fair value of its net assets related to its capital stock amount;
- its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;

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- the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and
  - its liquidity and funding position.

After evaluating all of these considerations, First National Community Bancorp, Inc. concluded that the par value of its investment in FHLB stock will be recovered. Accordingly, no impairment charge was recorded on these securities for the three months ended September 30, 2009. Our evaluation of the factors described above in future periods could result in the recognition of impairment charges on FHLB stock.

(6) Subsequent Events – In accordance with current accounting guidance, subsequent events have been evaluated through November 9, 2009, which is the date the financial statements were available to be issued. Through that date, there were no events requiring disclosure.

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

### Forward Looking Statements

This quarterly report contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Actual results and trends could differ materially from those set forth in such statements due to various risks, uncertainties and other factors. Such risks, uncertainties and other factors that could cause actual results and experience to differ include, but are not limited to, the following: the strategic initiatives and business plans may not be satisfactorily completed or executed, if at all; increased demand or prices for the company's financial services and products may not occur; changing economic and competitive conditions; technological developments; the effectiveness of the company's business strategy due to changes in current or future market conditions; actions of the U.S. government, Federal Reserve and other governmental and regulatory bodies for the purpose of stabilizing the financial markets; effects of deterioration of economic conditions on customers specifically the effect on loan customers to repay loans; inability of the company to raise or achieve desired or required levels of capital; paying significantly higher Federal Deposit Insurance Corporation (FDIC) premiums in the future; the effects of competition, and of changes in laws and regulations, including industry consolidation and development of competing financial products and services; interest rate movements; relationships with customers and employees; challenges in establishing and maintaining operations; volatilities in the securities markets and related potential impairments of investment securities; and deteriorating economic conditions and declines in housing prices and real estate values and other risks and uncertainties, including those detailed in the company's filings with the Securities and Exchange Commission. When we use words such as "believes", "expects", "anticipates", or similar expressions, we are making forward-looking statements. The company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report.

Readers should carefully review the risk factors described in the Annual Report and other documents that we periodically file with the Securities and Exchange Commission, including our Form 10-K for the year ended December 31, 2008.

The consolidated financial information of First National Community Bancorp, Inc. (the "company") provides a comparison of the performance of the company for the periods ended September 30, 2009 and 2008. The financial information presented should be read in conjunction with the consolidated financial statements and accompanying notes appearing elsewhere in this report.

### Background

The company is a Pennsylvania Corporation, incorporated in 1997 and is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended. The company became an active bank holding company

on July 1, 1998 when it assumed ownership of First National Community Bank (the “bank”). On November 2, 2000, the Federal Reserve Bank of Philadelphia approved the company’s application to change its status to a financial holding company as a complement to the company’s strategic objective which includes expansion into financial services activities. The bank is a wholly-owned subsidiary of the company.

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The company's primary activity consists of owning and operating the bank, which provides the customary retail and commercial banking services to individuals and businesses. The bank provides practically all of the company's earnings as a result of its banking services. As of September 30, 2009, the company had 20 full-service branch banking offices in its principal market area in Lackawanna, Luzerne, Wayne and Monroe Counties, Pennsylvania. At September 30, 2009, the company had 294 full-time equivalent employees.

The bank was established as a national banking association in 1910 as "The First National Bank of Dunmore." Based upon shareholder approval received at a Special Shareholders' Meeting held October 27, 1987, the bank changed its name to "First National Community Bank" effective March 1, 1988. The bank's operations are conducted from offices located in Lackawanna, Luzerne, Wayne and Monroe Counties, Pennsylvania:

Office	Date Opened
Main	October 1910
Scranton	September 1980
Dickson City	December 1984
Keyser Village	April 2008 (formerly Fashion Mall; July 1988)
Wilkes-Barre	July 1993
Pittston Plaza	April 1995
Kingston	August 1996
Exeter	November 1998
Daleville	April 2000
Plains	June 2000
Back Mountain	October 2000
Clarks Green	October 2001
Hanover Township	January 2002
Nanticoke	April 2002
Hazleton	October 2003
Route 315	February 2004
Honesdale	November 2006
Stroudsburg	May 2007
Honesdale Route 6	October 2007
Marshalls Creek	May 2008

The bank provides the usual commercial banking services to individuals and businesses, including a wide variety of loan, deposit instruments and investment options. As a result of the bank's partnership with FNCB Investment Services, our customers are able to access alternative products such as mutual funds, bonds, equities and annuities directly from our FNCB Investment Services representatives.

During 1996, FNCB Realty Inc. was formed as a wholly owned subsidiary of the Bank to manage, operate and liquidate properties acquired through foreclosure.

**Summary:**

The company recorded a net loss of \$5,162,000 for the nine months ended September 30, 2009 compared to net income of \$12,027,000 for the same period of the previous year which was a decrease of 143%. The decrease is primarily due to a \$19.6 million increase in the provision for credit losses caused by deteriorating economic conditions which was partially offset by a \$639,000 improvement in net interest income before the provision for credit losses which reflects the benefits derived from balance sheet growth and the repricing of interest-sensitive assets and

liabilities. Other income decreased \$2,673,000 due to a \$2,781,000 impairment charge on securities. Other expenses increased \$3,156,000 over the same period of last year due primarily to an increase in FDIC insurance premiums of \$1,552,000, an increase in expenses of ORE of \$812,000 and a \$428,000 charge to fund the reserve for off-balance sheet commitments.

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The company recorded a net loss of \$6,184,000 for the three months ended September 30, 2009 compared to net income of \$4,327,000 for the same period of the previous year, as over \$10 million was utilized to fund the reserve for credit losses. Net interest income before the provision for credit losses decreased \$586,000, or 6% compared to the same period of the previous year. Other income for the quarter decreased \$2,966,000, due to the \$2,399,000 impairment charge, while other expenses increased \$1,633,000, or 25% due to an increase in expenses of ORE of \$774,000, an increase in the provision for off-balance sheet commitments of \$428,000 and an increase in FDIC insurance premiums of \$381,000.

**RESULTS OF OPERATIONS****Net Interest Income:**

The company's primary source of revenue is net interest income which totaled \$30,394,000 and \$29,755,000 (before the provision for credit losses) during the first nine months of 2009 and 2008, respectively. The year to date net interest margin (tax equivalent) increased five basis points to 3.55% in 2009 compared to 2008 comprised of an eighty-one basis point decrease in the yield earned on earning assets which was offset by a ninety-nine basis point decrease in the cost of interest-bearing liabilities. Excluding investment leveraging transactions, the 2009 margin would be 3.64% which is comparable to the 3.65% recorded during the first nine months of last year.

Earning assets increased \$40 million to \$1.278 billion during the first nine months of 2009 and total 92.2% of total assets, a slight decrease from the 94.2% at year-end.

**Yield/Cost Analysis**

The following tables set forth certain information relating to the company's Statement of Financial Condition and reflect the weighted average yield on assets and weighted average costs of liabilities for the periods indicated. Such yields and costs are derived by dividing the annualized income or expense by the weighted average balance of assets or liabilities, respectively, for the periods shown:

	Nine months ended September 30, 2009			Yield/ Cost
	Average Balance	Interest		
(Dollars in thousands)				
<b>Assets:</b>				
<b>Interest-earning assets:</b>				
Loans (taxable)	\$892,342	\$37,239	5.53	%
Loans (tax-free) (1)	51,216	1,747	6.92	
Investment securities (taxable)	164,829	6,179	4.99	
Investment securities (tax-free)(1)	111,636	3,796	6.97	
Time deposits with banks and federal funds sold	23,917	44	0.24	
<b>Total interest-earning assets</b>	<b>1,243,940</b>	<b>49,005</b>	<b>5.54</b>	<b>%</b>
Non-interest earning assets	87,767			
<b>Total Assets</b>	<b>\$1,331,707</b>			
<b>Liabilities and Shareholders' Equity:</b>				
<b>Interest-bearing liabilities:</b>				
Deposits	\$901,650	\$12,916	1.92	%
Borrowed funds	239,624	5,695	3.13	
<b>Total interest-bearing liabilities</b>	<b>1,141,274</b>	<b>18,611</b>	<b>2.17</b>	<b>%</b>
Other liabilities and shareholders' equity	190,433			
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$1,331,707</b>			
<b>Net interest income/rate spread</b>		<b>\$30,394</b>	<b>3.37</b>	<b>%</b>

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Net yield on average interest-earning assets	3.55	%
Interest-earning assets as a percentage of interest-bearing liabilities	109	%

(1) Yields on tax-exempt loans and investment securities have been computed on a tax equivalent basis.  
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	Nine months ended September 30, 2008			
	Average Balance	Interest	Yield/ Cost	
	(Dollars in thousands)			
Assets:				
Interest-earning assets:				
Loans (taxable)	\$874,670	\$42,777	6.45	%
Loans (tax-free) (1)	47,610	1,688	7.17	
Investment securities (taxable)	198,026	8,467	5.68	
Investment securities (tax-free)(1)	84,519	2,682	6.51	
Time deposits with banks and federal funds sold	895	12	1.71	
Total interest-earning assets	1,205,720	55,626	6.35	%
Non-interest earning assets	86,943			
Total Assets	\$1,292,663			
Liabilities and Shareholders' Equity:				
Interest-bearing liabilities:				
Deposits	\$851,363	\$18,525	2.91	%
Borrowed funds	236,377	7,346	4.08	
Total interest-bearing liabilities	1,087,740	25,871	3.16	%
Other liabilities and shareholders' equity	204,923			
Total Liabilities and Shareholders' Equity	\$1,292,663			
Net interest income/rate spread		\$29,755	3.19	%
Net yield on average interest-earning assets			3.50	%
Interest-earning assets as a percentage of interest-bearing liabilities			111	%

(1) Yields on tax-exempt loans and investment securities have been computed on a tax equivalent basis.

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## Rate Volume Analysis

The table below sets forth certain information regarding the changes in the components of net interest income for the periods indicated. For each category of interest earning asset and interest bearing liability, information is provided on changes attributed to: (1) changes in rate (change in rate multiplied by current volume); (2) changes in volume (change in volume multiplied by old rate); (3) the total. The net change attributable to the combined impact of volume and rate has been allocated proportionately to the change due to volume and the change due to rate (in thousands).

	Period Ended September 30, 2009 vs 2008		
	Increase (Decrease)		
	Due to		
	Rate	Volume	Total
Loans (taxable)	\$(6,322 )	\$784	\$(5,538 )
Loans (tax-free)	(56 )	115	59
Investment securities (taxable)	(810 )	(1,478 )	(2,288 )
Investment securities (tax-free)	253	861	1,114
Time deposits with banks and federal funds sold	(265 )	297	32
Total interest income	\$(7,200 )	\$579	\$(6,621 )
Deposits	\$(6,540 )	\$931	\$(5,609 )
Borrowed funds	(1,752 )	101	(1,651 )
Total interest expense	\$(8,292 )	\$1,032	\$(7,260 )
Net change in net interest income	\$1,092	\$(453 )	\$639

	Period Ended September 30, 2008 vs 2007		
	Increase (Decrease)		
	Due to		
	Rate	Volume	Total
Loans (taxable)	\$(8,106 )	\$1,973	\$(6,133 )
Loans (tax-free)	(60 )	413	353
Investment securities (taxable)	395	73	468
Investment securities (tax-free)	(192 )	306	114
Time deposits with banks and federal funds sold	(23 )	11	(12 )
Total interest income	\$(7,986 )	\$2,776	\$(5,210 )
Deposits	\$(6,284 )	\$(591 )	\$(6,875 )
Borrowed funds	(1,633 )	2,639	1,006
Total interest expense	\$(7,917 )	\$2,048	\$(5,869 )
Net change in net interest income	\$(69 )	\$728	\$659

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## Other Income and Expenses:

Other income in the first nine months of 2009 decreased \$2,673,000 in comparison to the same period of 2008 primarily due to a \$2,781,000 other-than-temporary impairment loss on securities. Service charges and fees decreased \$154,000 compared to the prior period. Income from service charges on deposits decreased \$178,000, or 9%, in comparison to the same period of last year. Other fee income increased \$24,000, or 1%. Net gains from asset sales increased \$262,000 comprised of a \$907,000 increase in gains on residential mortgage loans to reduce the risk to rising rates; a \$230,000 decrease in security gains as securities were sold to restructure the portfolio and to generate liquidity to meet loan demand; and a \$415,000 decrease in gains on other real estate sold.

Other expenses increased \$3,156,000 or 17% for the period ended September 30, 2009 compared to the same nine month period of the previous year. Salaries and Benefits costs decreased \$39,000 in comparison to the first nine months of 2008. Occupancy and equipment costs increased \$108,000, or 4%, data processing expenses increased \$64,000, or 5%, FDIC insurance expense increased \$1,552,000 due to increased premiums, bank shares tax expense increased \$161,000, or 33%, expenses of other real estate increased \$812,000 and a \$428,000 charge to fund the reserve for off-balance sheet commitments.

On a quarterly basis, other income for the third quarter of 2009 decreased \$2,966,000 in comparison to the same quarter of 2008 due to a \$10.7 million increase in the provision for credit losses and \$2,399,000 in other-than-temporary impairment losses on securities. Service charges and fees decreased \$10,000 when compared to the prior period. Net gains from asset sales decreased \$557,000 when compared to the third quarter of 2008.

Other expenses for the third quarter of 2009 increased \$1,633,000, or 25% in comparison to the same period of 2008 primarily due to an increase in expenses of other real estate of \$774,000 and FDIC insurance premiums of \$381,000 and a \$428,000 charge to fund the reserve for off-balance sheet commitments.

## Other Comprehensive Income:

The Company's other comprehensive income includes unrealized holding gains (losses) on securities which it has classified as available-for-sale in accordance with current accounting guidance.

## Provision for Income Taxes:

The provision for income taxes is calculated based on annualized taxable income. The provision for income taxes differs from the amount of income tax determined applying the applicable U.S. statutory federal income tax rate to pre-tax income from continuing operations as a result of the following differences:

	2009		2008
Provision at statutory rate	\$(3,048	)	\$5,394
Add (Deduct):			
Tax effect of non-taxable interest income	(1,885	)	(1,486 )
Tax effect of other tax free income	(230	)	(269 )
Non-deductible interest expense	173		194
Tax benefit from stock options exercised	(11	)	(48 )
Deferred tax benefits	(21	)	(19 )
Other timing differences	1,175		0
Other items, net	45		43
Income tax expense	\$(3,802	)	\$3,809

## Federal Deposit Insurance Corporation ("FDIC") Activity:

The Federal Deposit Insurance Reform Act of 2005 ("the Act") amended regulations to create a new risk differentiation system, to establish a new base assessment rate schedule, and to set assessment rates effective January 1, 2007. Also, eligible insured depository institutions shared in a one-time assessment credit, which was approximately \$445,000 for

the bank. The bank used \$385,000 of this credit for the year ended December 31, 2007, and the remaining \$60,000 for the year ended December 31, 2008.

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On February 27, 2009, The Board of Directors of the FDIC voted to amend the restoration plan for the Deposit Insurance Fund (“DIF”). Under the current restoration plan, the FDIC Board set a rate schedule to raise the DIF reserve ratio to 1.15 percent within seven years. The amended restoration plan was accompanied by a final rule that sets assessment rates and makes adjustments that improve how the assessment system differentiates for risk.

Currently, most banks are in the best risk category and pay anywhere from 12 cents per \$100 of deposits to 14 cents per \$100 for insurance. Under the final rule, banks in this category will pay initial base rates ranging from 12 cents per \$100 to 16 cents per \$100 on an annual basis, beginning on April 1, 2009. Changes to the assessment system include higher rates for institutions that rely significantly on secured liabilities, which may increase the FDIC's loss in the event of failure without providing additional assessment revenue. Under the final rule, assessments will be higher for institutions that rely significantly on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth. Brokered deposits combined with rapid asset growth have played a role in a number of costly failures, including recent failures. The final rule also would provide incentives in the form of a reduction in assessment rates for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital.

The FDIC Board also adopted the final rule imposing a 5 basis point emergency special assessment on the industry on June 30, 2009. The assessment was collected on September 30, 2009. For the bank, based upon our deposit levels at June 30, 2009, the additional amount of 2009 FDIC insurance expense related to this special assessment was \$603,000. This adjustment was recognized during the second quarter of 2009. On September 29, 2009, the FDIC Board adopted a proposed rulemaking that would require banks to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. Under the proposed rulemaking, banks would be assessed through 2010 according to the risk-based premium schedule adopted earlier this year. Beginning January 1, 2011, the base rate would increase by 3 basis points.

## Securities:

Carrying amounts and approximate fair value of investment securities are summarized as follows (in thousands):

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	\$15,343	\$15,343	\$32,233	\$32,233
Obligations of state & political subdivisions	129,653	129,708	101,451	101,417
Collateralized mortgage obligations				
Government sponsored agency	32,784	32,784	29,223	29,223
Private label	27,011	27,011	31,840	31,840
Residential mortgage-backed securities	25,220	25,220	30,061	30,061
Pooled Trust Preferred Senior Class	2,810	2,810	2,775	2,775
Pooled Trust Preferred Mezzanine Class	12,495	12,495	14,877	14,877
Corporate debt securities	4,128	4,128	4,274	4,274
Equity securities and mutual funds	1,005	1,005	974	974
Total	\$250,449	\$250,504	\$247,708	\$247,674

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The following summarizes the amortized cost, approximate fair value, gross unrealized holding gains, and gross unrealized holding losses at September 30, 2009 of the company's Investment Securities classified as available-for-sale (in thousands):

	Amortized Cost	September 30, 2009 Gross Unrealized Holding Gains	September 30, 2009 Gross Unrealized Holding Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies:	\$17,712	\$149	\$2,518	\$15,343
Obligations of state and political subdivisions:	122,787	7,345	2,355	127,777
Collateralized mortgage obligations:				
Government sponsored agency	31,885	955	56	32,784
Private label	32,604	53	5,646	27,011
Residential mortgage-backed securities:	23,743	1,477	0	25,220
Pooled Trust Preferred Senior Class	3,843	0	1,033	2,810
Pooled Trust Preferred Mezzanine Class	28,943	0	16,448	12,495
Corporate debt securities:	4,306	13	191	4,128
Equity securities and mutual funds:	1,010	0	5	1,005
Total	\$266,833	\$9,992	\$28,252	\$248,573

The following summarizes the amortized cost, approximate fair value, gross unrealized holding gains, and gross unrealized holding losses at September 30, 2009 of the company's Investment Securities classified as held-to-maturity (dollars in thousands):

	Amortized Cost	September 30, 2009 Gross Unrealized Holding Gains	September 30, 2009 Gross Unrealized Holding Losses	Fair Value
Obligations of state and political subdivisions:	\$1,876	\$55	\$0	\$1,931
Total	\$1,876	\$55	\$0	\$1,931

The following table shows the amortized cost and approximate fair value of the company's debt securities at September 30, 2009 using contractual maturities. Expected maturities will differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands).

	Available- for sale Amortized Cost	Fair Value	Held-to-maturity Amortized Cost	Fair Value
Amounts maturing in:				
One year or less	\$502	\$503	\$0	\$0
After one year through five years	2,455	2,530	0	0
After five years through ten years	8,852	8,967	453	463
After ten years	165,782	150,553	1,423	1,468
Collateralized mortgage obligations	64,489	59,795	0	0
Mortgage-backed securities	23,743	25,220	0	0
Total	\$265,823	\$247,568	\$1,876	\$1,931

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Gross proceeds from the sale of investment securities for the periods ended September 30, 2009 and 2008 were \$24,116,954 and \$65,239,682 respectively with the gross realized gains being \$1,217,412 and \$1,078,417 respectively, and gross realized losses being \$422,181 and \$53,562 respectively.

At September 30, 2009 and 2008, investment securities with a carrying amount of \$202,619,358 and \$192,839,216 respectively, were pledged as collateral to secure public deposits and for other purposes.

### Impairment of Investment Securities

Investment Securities: The credit loss component of an other-than-temporary impairment write-down is recorded in earnings, while the remaining portion of the impairment loss is recognized in other comprehensive income, provided the company does not intend to sell the underlying debt security. In the second quarter of 2009 we recorded a \$382,000 other-than-temporary charge. This charge includes \$242,000 in credit related other-than-temporary impairment on a trust preferred collateralized debt obligation and \$140,000 recorded on a private label mortgage-backed security. All of the securities for which other-than-temporary impairment was recorded were classified as available for sale securities. Additionally, \$3.3 million in noncredit related other-than-temporary impairment was recorded in OCI on the two securities which were classified as impaired.

During the third quarter of 2009, the company recorded a \$2.4 million other-than-temporary impairment (OTTI) charge on debt securities. This charge includes \$1,675,000 in credit related OTTI on four pooled trust preferred collateralized debt obligations and \$724,000 on four private label mortgage-backed securities. All of the securities for which OTTI was recorded were classified as available-for-sale. Additionally, a \$2.6 million decrease in noncredit related OTTI was recorded on the eight securities which incurred credit related impairment, comprised of a \$1.0 million improvement on trust preferred securities and a \$1.6 million improvement in the value of the private label mortgage-backed securities.

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market. We evaluate our intent and ability to hold debt securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, the risk of future other-than-temporary impairment may be influenced by additional bank failures, prolonged recession in the U.S. economy, changes in real estate values, interest deferrals, and whether the federal government provides assistance to financial institutions. Our pooled trust preferred collateralized debt obligations are beneficial interests in securitized financial assets within the scope of current accounting guidance, and are therefore evaluated for other-than-temporary impairment using management's best estimate of future cash flows. If these estimated cash flows determine that it is probable an adverse change in cash flows has occurred, then other-than-temporary impairment would be recognized. There is a risk that this quarterly review could result in First National Community Bancorp, Inc. recording additional other-than-temporary impairment charges in the future.

At September 30, 2009, 17% of the total unrealized losses were comprised of fixed income securities issued by U.S. Government agencies, U.S. Government-sponsored enterprises and investment grade municipalities. Corporate fixed income comprised 1% of the total unrealized losses, while pooled trust preferred collateralized debt obligations accounted for 62% and 20% came from private label mortgage-backed securities..

As of September 30, 2009, the amortized cost of our pooled trust preferred collateralized debt obligations totaled \$32.8 million with an estimated fair value of \$15.3 million. One of our pooled securities is a senior tranche and the remainder are mezzanine tranches. During 2009, all of the pooled issues were downgraded by Moody's Investor Services. At the time of initial issue, no more than 5% of any pooled security consisted of a security issued by any

one institution.

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Lack of liquidity in the market for trust preferred collateralized debt obligations, credit rating downgrades and market uncertainties related to the financial industry are factors contributing to the temporary impairment on these securities.

On a quarterly basis we evaluate our debt securities for other-than-temporary impairment. In the third quarter of 2009, \$1,675,000 in other-than-temporary impairment charges were recognized on our pooled trust preferred collateralized debt obligations. When evaluating these investments we determine a credit related portion and a noncredit related portion of other-than-temporary impairment. The credit related portion is recognized in earnings and represents the expected shortfall in future cash flows. The noncredit related portion is recognized in other comprehensive income and represents the difference between the fair value of the security and the amount of credit related impairment. A discounted cash flow analysis provides the best estimate of credit related other-than-temporary impairment for these securities.

Our pooled trust preferred collateralized debt obligations are measured for other-than-temporary impairment within the scope of current accounting guidance by determining whether it is probable that an adverse change in estimated cash flows has occurred. Determining whether there has been an adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of remaining cash flows previously projected against the present value of the cash flows estimated at September 30, 2009. We consider the discounted cash flow analysis to be our primary evidence when determining whether credit related other-than-temporary impairment exists.

The following table presents the gross unrealized losses and fair values at September 30, 2009 for both available for sale and held to maturity securities by investment category and time frame for which the loss has been outstanding (dollars in thousands):

Description of Securities	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government agencies	\$1,495	\$5	\$8,418	\$2,513	\$9,913	\$2,518
Obligation of state and political subdivisions	0	0	21,422	2,355	21,422	2,355
Collateralized mortgage obligations						
Government sponsored agency	7,183	56	0	0	7,183	56
Private Label						