

FIRST NATIONAL COMMUNITY BANCORP INC  
Form 10-Q/A  
July 09, 2009  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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**FORM 10-Q/A**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 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) (I.R.S. Employer  
of Incorporation or Organization) 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

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(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

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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   
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**

**16,154,176 shares**

(Title of Class)

(Outstanding at May 8, 2009)

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## EXPLANATORY NOTE

This amendment on Form 10-Q/A (THIS "Amendment") amends the quarterly report on Form 10-Q for the quarterly period ended March 31, 2009 originally filed with the Securities and Exchange Commission on May 8, 2009 of First National Community Bancorp, Inc. (the "Original Form 10-Q"). The purpose of this Amendment is to revise an error made in the March 31, 2009 financial statements. The error related to a \$2.1 million provision to the allowance for credit losses which the Company originally determined should be allocated to the quarter ended June 30, 2009 but was later determined that it should have been properly attributed to the quarter ended March 31, 2009. The Amendment specifically revises Part I, Items 1 and 2. Except for the changes to Part I, Items 1 and 2 in this Amendment, the remainder of the Original Form 10-Q shall remain in effect as of the date of filing the Original Form 10-Q. Additionally, this Amendment does not purport to provide an update or discussion of any other developments subsequent to the filing of the Original Form 10-Q.

FIRST NATIONAL COMMUNITY BANCORP, INC.

## INDEX

| PART I                |   | Page       |
|-----------------------|---|------------|
| FINANCIAL INFORMATION |   | <u>No.</u> |
| Item 1.               | Consolidated Financial Statements.<br>Consolidated Statements of Financial Condition  |            |
|                       | March 31, 2009 (restated) (unaudited) and December 31, 2008<br>Consolidated Statements of Income  | 1          |
|                       | Three Months Ended March 31, 2009 (restated) and March 31, 2008 (unaudited)<br>Consolidated Statements of Cash Flows                      | 2          |
|                       | Three Months Ended March 31, 2009 (restated) and March 31, 2008 (unaudited)<br>Consolidated Statements of Changes in Stockholders' Equity | 3          |
|                       | Three Months Ended March 31, 2009 (restated) (unaudited)<br>Notes to Consolidated Financial Statements                                    | 5<br>6     |
| Item 2.               | Management's Discussion and Analysis of Financial Condition and Results of Operations.  | 8          |
| PART II               |   |            |
| OTHER INFORMATION     |   | 20         |
| Item 6.               | Exhibits.   |            |
| Signatures            |   | 21         |

(ii)

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FIRST NATIONAL COMMUNITY BANCORP, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in thousands)

|   | March 31,<br>2009<br>(RESTATED)<br>(UNAUDITED) | December 31,<br>2008<br>(AUDITED) |
|---|--|-----------------------------------|
| <b>ASSETS</b>   |  |                                   |
| Cash and cash equivalents:  |  |                                   |
| Cash and due from banks   | \$ 17,536                                      | \$ 18,171                         |
| Federal funds sold  | 0  | 0                                 |
| Total cash and cash equivalents   | 17,536   | 18,171                            |
| Securities:   |  |                                   |
| Available-for-sale, at fair value   | 220,566  | 245,900                           |
| Held-to-maturity, at cost (fair value \$1,856 on March 31, 2009 and \$1,774 on December 31, 2008) | 1,830  | 1,808                             |
| Federal Reserve Bank and FHLB stock, at cost  | 11,515   | 11,087                            |
| Net loans   | 975,354  | 956,674                           |
| Bank premises and equipment   | 17,683   | 17,785                            |
| Intangible Assets   | 9,836  | 9,781                             |
| Other assets  | 56,930   | 52,553                            |
| Total Assets  | \$1,311,250                                    | \$1,313,759                       |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |  |                                   |
| Liabilities:  |  |                                   |
| Deposits:   |  |                                   |
| Demand – non-interest bearing   | \$ 77,083                                      | \$ 79,760                         |
| Interest bearing demand   | 295,221  | 302,058                           |
| Savings   | 78,276   | 79,526                            |
| Time (\$100,000 and over)   | 205,421  | 191,052                           |
| Other time  | 311,039  | 300,496                           |
| Total deposits  | 967,040  | 952,892                           |
| Borrowed funds  | 236,147  | 245,197                           |
| Other liabilities   | 13,026   | 15,328                            |
| Total Liabilities   | \$1,216,213                                    | \$1,213,417                       |
| Shareholders' equity:   |  |                                   |
| Common Stock, \$1.25 par value,   |  |                                   |
| Authorized: 50,000,000 shares   |  |                                   |
| Issued and outstanding:   |  |                                   |
| 16,154,176 shares at March 31, 2009 and   |  |                                   |
| 16,047,928 shares at December 31, 2008  | \$ 20,193                                      | \$ 20,060                         |

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|   |             |             |
|---|-------------|-------------|
| Additional Paid-in Capital                    | 60,506      | 59,591      |
| Retained Earnings                             | 42,365      | 40,892      |
| Accumulated Other Comprehensive Income (Loss) | (28,027)    | (20,201)    |
| Total shareholders' equity                    | \$ 95,037   | \$ 100,342  |
| Total Liabilities and Shareholders' Equity    | \$1,311,250 | \$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

(1)

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## FIRST NATIONAL COMMUNITY BANCORP, INC.

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands, except per share amounts)

|  | Three Months Ended              |                   |
|--|---------------------------------|-------------------|
|  | March 31,<br>2009<br>(RESTATED) | March 31,<br>2008 |
| Interest Income:                               |                                 |                   |
| Loans  | \$ 13,358                       | \$ 15,491         |
| Investments                                    | 3,492                           | 3,909             |
| Federal Funds Sold                             | 0                               | 0                 |
| Total interest income                          | 16,850                          | 19,400            |
| Interest Expense:                              |                                 |                   |
| Deposits                                       | 4,145                           | 6,861             |
| Borrowed Funds                                 | 2,038                           | 2,700             |
| Total interest expense                         | 6,183                           | 9,561             |
| Net Interest Income before Loan Loss Provision | 10,667                          | 9,839             |
| Provision for credit losses                    | 2,460                           | 300               |
| Net interest income                            | 8,207                           | 9,539             |
| Other Income:                                  |                                 |                   |
| Service charges                                | 687                             | 729               |
| Other Income                                   | 663                             | 627               |
| Gain / (Loss) on sale of:                      |                                 |                   |
| Loans  | 546                             | 206               |
| Securities                                     | 527                             | 645               |
| Other Real Estate                              | 0                               | 0                 |
| Total other income                             | 2,423                           | 2,207             |
| Other expenses:                                |                                 |                   |
| Salaries & benefits                            | 3,332                           | 3,089             |
| Occupancy & equipment                          | 1,070                           | 1,011             |
| Advertising expense                            | 240                             | 240               |
| Data processing expense                        | 436                             | 418               |
| FDIC Assessment                                | 240                             | 95                |
| Bank Shares Tax                                | 217                             | 170               |
| Other  | 1,142                           | 1,108             |
| Total other expenses                           | 6,677                           | 6,131             |
| Income before income taxes                     | 3,953                           | 5,615             |
| Income tax expense                             | 715                             | 1,424             |
| NET INCOME                                     | 3,238                           | \$ 4,191          |
| Basic earnings per share                       | \$ 0.20                         | \$ 0.27           |
| Diluted earnings per share                     | \$ 0.20                         | \$ 0.26           |
| Weighted average number of basic shares        | 16,064,455                      | 15,759,321        |

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|   |            |            |
|---|------------|------------|
| Weighted average number of diluted shares | 16,460,979 | 16,112,913 |
|---|------------|------------|

See notes to financial statements

(2)

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FIRST NATIONAL COMMUNITY BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED MARCH 31, 2009 AND 2008

(UNAUDITED)

|  | March 31,<br>2009<br>(RESTATED)<br>(Dollars in thousands) | March 31,<br>2008 |
|--|---|-------------------|
| INCREASE (DECREASE) IN CASH EQUIVALENTS:   |   |                   |
| Cash Flows From Operating Activities:  |   |                   |
| Interest Received  | \$ 16,544   | \$ 19,588         |
| Fees & Commissions Received  | 1,379   | 1,372             |
| Interest Paid  | (7,284)   | (10,763)          |
| Income Taxes Paid  | (1,132)   | (618)             |
| Cash Paid to Suppliers & Employees   | (8,528)   | (6,149)           |
| Net Cash Provided by Operating Activities  | \$ 979  | \$ 3,430          |
| Cash Flows from Investing Activities:  |   |                   |
| Securities available for sale:   |   |                   |
| Proceeds from Sales prior to maturity  | \$ 9,142  | \$ 51,580         |
| Proceeds from Calls prior to maturity  | 13,538  | 9,330             |
| Purchases  | (8,354)   | (20,797)          |
| Net Increase in Loans to Customers   | (19,878)  | (24,042)          |
| Capital Expenditures   | (283)   | (1,203)           |
| Net Cash Provided/(Used) by Investing Activities   | \$(5,835)   | \$ 14,868         |
| Cash Flows from Financing Activities:  |   |                   |
| Net Decrease in Demand Deposits, Money Market Demand, NOW Accounts, and Savings Accounts |   |                   |
|  | \$(10,764)  | \$(19,827)        |
| Net Increase/(Decrease) in Certificates of Deposit                                       | 24,912  | (12,918)          |
| Net Increase/(Decrease) in Borrowed Funds  | (9,050)   | 19,872            |
| Net Proceeds from Issuance of Common Stock Through Dividend Reinvestment                 |   |                   |
|  | 889   | 707               |
| Net Proceeds from Issuance of Common Stock – Stock Option Plans                          |   |                   |
|  | 0   | 76                |
| Dividends Paid   | (1,766)   | (1,733)           |
| Net Cash Provided/(Used) by Financing Activities   | \$ 4,221  | \$(13,823)        |
| Net Increase/(Decrease) in Cash and Cash Equivalents                                     | \$ (635)  | \$ 4,475          |
| Cash & Cash Equivalents at Beginning of Year   | \$ 18,171   | \$ 24,735         |
| CASH & CASH EQUIVALENTS AT END OF PERIOD   | \$ 17,536   | \$ 29,210         |

(Continued)

(3)

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FIRST NATIONAL COMMUNITY BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOW (CONTINUED)  
THREE MONTHS ENDED MARCH 31, 2009 AND 2008

(UNAUDITED)

|   | 2009<br>(RESTATED)     | 2008    |
|---|------------------------|---------|
|   | (Dollars in thousands) |         |
| RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:        |                        |         |
| Net Income  | \$ 3,238               | \$4,191 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: |                        |         |
| Amortization (Accretion), Net   | (952)                  | (846)   |
| Equity in trust   | (2)                    | (3)     |
| Depreciation and Amortization   | 458                    | 438     |
| Provision for Probable Credit Losses  | 2,460                  | 300     |
| Provision for Deferred Taxes  | (56)                   | (50)    |
| Gain on Sale of Loans   | (546)                  | (205)   |
| Gain on Sale of Investment Securities   | (527)                  | (645)   |
| Increase/(Decrease) in Taxes Payable  | (505)                  | 110     |
| Decrease in Interest Receivable   | 646                    | 1,034   |
| Decrease in Interest Payable  | (1,101)                | (1,202) |
| Increase in Prepaid Expenses and Other Assets                                     | (1,596)                | (494)   |
| Increase/(Decrease) in Accrued Expenses and Other Liabilities                     | (538)                  | 802     |
| Total Adjustments   | \$(2,259)              | \$(761) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES   | \$ 979                 | \$3,430 |

See notes to financial statements

(4)

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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CHANGES IN  
 STOCKHOLDERS' EQUITY

For The Three Months Ended March 31, 2009

(RESTATED)

(In thousands, except share data)

(UNAUDITED)

|  | COMP-REHEN-SIVE |         | ADD'L                  |                    | ACCUM-<br>ULATED OTHER<br>COMP-REHEN-SIVE<br>INCOME/<br>(LOSS) | TOTAL    |            |           |
|--|-----------------|---------|------------------------|--------------------|--|----------|------------|-----------|
|  | INCOME          |         | COMMON STOCK<br>SHARES | PAID-IN<br>CAPITAL | RETAINED<br>EARNINGS   |          |            |           |
| BALANCES, DECEMBER<br>31, 2008   |                 |         | 16,047,928             | \$20,060           | \$59,591   | \$40,892 | \$(20,201) | \$100,342 |
| Comprehensive Income:  |                 |         |                        |                    |  |          |            |           |
| Net income for the period  | 3,238           |         |                        |                    |  | 3,238    |            | 3,238     |
| Other comprehensive<br>income, net of tax:   |                 |         |                        |                    |  |          |            |           |
| Unrealized loss on<br>securities<br>available-for-sale, net of<br>deferred income tax<br>benefit of \$4,398        |                 | (8,353) |                        |                    |  |          |            |           |
| Reclassification<br>adjustment for gain or<br>loss included in income,<br>net of deferred income<br>taxes of \$184 |                 |         |                        |                    |  |          |            |           |
|  | 527             |         |                        |                    |  |          |            |           |
| Total other<br>comprehensive<br>income/(loss), net of tax  | (7,826)         |         |                        |                    |  |          | (7,826)    | (7,826)   |
| Comprehensive<br>Income/(Loss)   | (4,588)         |         |                        |                    |  |          |            |           |
| Stock Options Awarded  |                 |         |                        |                    | 159  |          |            | 159       |
| Issuance of Common Stock<br>through Dividend<br>Reinvestment   |                 |         | 106,248                | 133                | 756  |          |            | 889       |
| Cash dividends paid, \$0.11<br>per share   |                 |         |                        |                    |  | (1,765)  |            | (1,765)   |
| BALANCES, MARCH 31,<br>2009  |                 |         | 16,154,176             | \$20,193           | \$60,506   | \$42,365 | \$(28,027) | \$95,037  |

See notes to financial statements

(5)

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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 March 31, 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) 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 16,064,455 and 15,759,321 for the periods ending March 31, 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 16,460,979 and 16,112,913 for the periods ending March 31, 2009 and 2008, respectively.

(3) During the first quarter of calendar 2003, the Company adopted the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, for stock-based employee compensation, effective as of January 1, 2003. Under the prospective method of adoption selected by the Company, stock-based compensation cost will be recognized using the fair value method for all awards granted, modified or settled on or after that effective date.

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

|  | Three months ended March 31,<br>2009 |  | 2008     |  |
|--|--------------------------------------|--|----------|--|
|  | Shares                               | Weighted<br>Average<br>Exercise<br>Price | Shares   | Weighted<br>Average<br>Exercise<br>Price |
| Outstanding at the beginning of the period | 325,134                              | \$12.36                                  | 360,694  | \$11.93                                  |
| Granted                                    | 74,600                               | 10.81                                    | 0        |  |
| Exercised                                  | 0                                    |  | (12,750) | 5.93                                     |
| Forfeited                                  | 0                                    |  | (2,061)  | 19.72                                    |
| Outstanding at the end of the period       | 399,734                              | 12.07                                    | 345,883  | 12.10                                    |
| Options exercisable at March 31,           | 325,134                              | 12.36                                    | 297,258  | 11.32                                    |

Weighted average fair value of options granted  
during the period

2.13

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(6)

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Information pertaining to options outstanding at March 31, 2009 is as follows:

| Range of Exercise Price | Options Outstanding    |   |  | Options Exercisable    |  |
|-------------------------|------------------------|---|--|------------------------|--|
|                         | Number                 | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number                 | Weighted<br>Average<br>Exercise<br>Price |
| \$5.19-\$23.13          | Outstanding<br>399,734 | 6.1 years   | \$12.07                                  | Exercisable<br>325,134 | \$12.36                                  |

(4) The financial statements for March 31, 2009 have been restated to reflect:

(a) a \$2.1 million provision to the allowance for credit losses which the Company originally determined should be allocated to the quarter ended June 30, 2009 but was later determined that it should have been properly attributed to the quarter ended March 31, 2009,

(b) the income tax effect of the above in the amount of \$714,000, and

(c) the net income effect of \$1,386,000.

The following table illustrates the restatement:

|  |            | Basic        | Diluted  |
|--|------------|--------------|----------|
|  |            | Earnings per | Earnings |
|  |            | Share        | per      |
|  | Net Income |              | Share    |
| Net Income, as reported  | \$ 4,624   | \$ 0.29      | \$ 0.28  |
| Net adjustment for additional provision to the allowance for credit losses |            |              |          |
|  | (1,386)    | (0.09)       | (0.08)   |
| Net Income, as restated  | \$ 3,238   | \$ 0.20      | \$ 0.20  |

(7)

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

#### Forward Looking Statements

This quarterly report may contain 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 factors. Such factors include the possibility that anticipated cost savings may not be realized, estimated synergies may not occur, increased demand or prices for the company's financial services and products may not occur, changing economic and competitive conditions, technological developments and other risks and uncertainties. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: ineffectiveness of their business strategy due to changes in current or future market conditions; the effects of competition, and of changes in laws and regulations on competition, including industry consolidation and development of competing financial products and services; interest rate movements; difficulties in integrating distinct business operations, including information technology difficulties; disruptions making it more difficult to maintain relationships with customers and employees, and challenges in establishing and maintaining operations in new markets; volatilities or significant deterioration in the securities markets; and deteriorating economic conditions. 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.

Shareholders should note that many factors, some of which are discussed elsewhere in this document, the Annual Report on Form 10-K for the year ended December 31, 2008, the company's Forms 8-K, and in the documents that are incorporated by reference, could affect the future financial results of the company, the bank or the combined company and could cause those results to differ materially from those expressed in the forward-looking statements contained or incorporated by reference in this document. These factors include but are not limited to the following:

- Volatilities in the securities markets;
- Deteriorating economic conditions;
- Effects of deterioration of economic conditions on customers, specifically the effect on loan customers ability to repay loans;
- Operating, legal and regulatory risks;
- Economic, political and competitive forces;
- Rapidly changing technology; and
- Our analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

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 March 31, 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.

(8)

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### 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.

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 March 31, 2009, the company had 20 full-service branch banking offices in its principal market area in Lackawanna, Luzerne, Wayne and Monroe Counties, Pennsylvania. At March 31, 2009, the company had 285 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:

| <u>Office</u>     | <u>Date Opened</u>                            |
|-------------------|---|
| 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                                  |
| Marshall's 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.

(9)

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Summary:

Net income for the three months ended March 31, 2009 amounted to \$3,238,000, a decrease of \$953,000 or 23% compared to the same period of the previous year. The decrease is primarily due to a \$2.1 million increase in the provision for credit losses caused by deteriorating economic conditions which was partially offset by an \$828,000 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 increased \$216,000 primarily due to gains on the sale of loans of \$340,000, offset by a decrease in gains on security sales of \$118,000. Other expenses increased \$546,000 over the same period of last year due primarily to an increase in Salaries & Benefits of \$243,000, an increase in FDIC insurance of \$145,000, a \$59,000 increase in occupancy and equipment costs related to the company's expansion and an increase in other operating expenses of \$34,000.

RESULTS OF OPERATIONS

Net Interest Income:

The company's primary source of revenue is net interest income which totaled \$10,667,000 and \$9,839,000 (before the provision for credit losses) during the first three months of 2009 and 2008, respectively. The year to date net interest margin (tax equivalent) increased twenty-five basis points to 3.74% in 2009 compared to 2008 comprised of a ninety-four basis point decrease in the yield earned on earning assets which was offset by a one hundred thirty-four basis point decrease in the cost of interest-bearing liabilities. Excluding investment leveraging transactions, the 2009 margin would be 3.87% which is twenty-four basis points higher than the 3.63% recorded during the first three months of last year.

Earning assets decreased \$7 million to \$1.230 billion during the first three months of 2009 and total 93.8% 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:

(10)

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|  | Three months ended March 31,<br>2009 |          | Yield/ |
|--|--------------------------------------|----------|--------|
|  | Average                              |          | Cost   |
|  | Balance                              | Interest |        |
|  | (Dollars in thousands)               |          |        |
| Assets:  |                                      |          |        |
| Interest-earning assets:   |                                      |          |        |
| Loans (taxable)  | \$906,082                            | \$12,750 | 5.65%  |
| Loans (tax-free) (1)   | 53,362                               | 608      | 7.01   |
| Investment securities (taxable)  | 177,746                              | 2,272    | 5.11   |
| Investment securities (tax-free)(1)  | 108,663                              | 1,220    | 6.91   |
| Time deposits with banks and federal funds sold                            |                                      |          |        |
|  | 38                                   | 0        | 0.33   |
| Total interest-earning assets  | 1,245,891                            | 16,850   | 5.74%  |
| Non-interest earning assets  | 81,651                               |          |        |
| Total Assets   | \$1,327,542                          |          |        |
| Liabilities and Shareholders' Equity:                                      |                                      |          |        |
| Interest-bearing liabilities:  |                                      |          |        |
| Deposits   | \$871,625                            | \$ 4,145 | 1.93%  |
| Borrowed funds   | 264,729                              | 2,038    | 3.08   |
| Total interest-bearing liabilities   | 1,136,354                            | 6,183    | 2.20%  |
| Other liabilities and shareholders' equity                                 |                                      |          |        |
|  | 191,188                              |          |        |
| Total Liabilities and Shareholders' Equity                                 |                                      |          |        |
|  | \$1,327,542                          |          |        |
| Net interest income/rate spread  |                                      | \$10,667 | 3.54%  |
| Net yield on average interest-earning assets                               |                                      |          | 3.74%  |
| Interest-earning assets as a percentage of<br>interest-bearing liabilities |                                      |          | 110%   |

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

(11)

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|  | Three months ended March 31,<br>2008 |          | Yield/ |
|--|--------------------------------------|----------|--------|
|  | Average                              |          | Cost   |
|  | Balance                              | Interest |        |
|  | (Dollars in thousands)               |          |        |
| Assets:  |                                      |          |        |
| Interest-earning assets:   |                                      |          |        |
| Loans (taxable)  | \$861,653                            | \$14,935 | 6.88%  |
| Loans (tax-free) (1)   | 46,834                               | 556      | 7.11   |
| Investment securities (taxable)  | 210,581                              | 3,077    | 5.83   |
| Investment securities (tax-free)(1)  | 78,419                               | 832      | 6.53   |
| Time deposits with banks and federal funds sold                            |                                      |          |        |
|  | 0                                    | 0        | 0      |
| Total interest-earning assets  | 1,197,487                            | 19,400   | 6.68%  |
| Non-interest earning assets  | 84,674                               |          |        |
| Total Assets   | \$1,282,161                          |          |        |
| Liabilities and Shareholders' Equity:                                      |                                      |          |        |
| Interest-bearing liabilities:  |                                      |          |        |
| Deposits   | \$838,139                            | \$ 6,861 | 3.28%  |
| Borrowed funds   | 241,176                              | 2,700    | 4.43   |
| Total interest-bearing liabilities   | 1,079,315                            | 9,561    | 3.54%  |
| Other liabilities and shareholders' equity                                 |                                      |          |        |
|  | 202,846                              |          |        |
| Total Liabilities and Shareholders' Equity                                 |                                      |          |        |
|  | \$1,282,161                          |          |        |
| Net interest income/rate spread  |                                      | \$ 9,839 | 3.14%  |
| Net yield on average interest-earning assets                               |                                      |          |        |
|  |                                      |          | 3.49%  |
| Interest-earning assets as a percentage of<br>interest-bearing liabilities |                                      |          |        |
|  |                                      |          | 111%   |

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

(12)

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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 March 31, |           |           |
|---|------------------------|-----------|-----------|
|   | 2009 vs 2008           |           |           |
|   | Increase (Decrease)    |           |           |
|   | Due to                 |           |           |
|   | Rate                   | Volume    | Total     |
| Loans (taxable)                                 | \$(2,796)              | \$ 611    | \$(2,185) |
| Loans (tax-free)                                | (11)                   | 63        | 52        |
| Investment securities (taxable)                 | (448)                  | (357)     | (805)     |
| Investment securities (tax-free)                | 320                    | 68        | 388       |
| Time deposits with banks and federal funds sold | 0                      | 0         | 0         |
| Total interest income                           | \$(2,935)              | \$ 385    | \$(2,550) |
| Deposits  | \$(3,142)              | \$ 426    | \$(2,716) |
| Borrowed funds                                  | (1,639)                | 977       | (662)     |
| Total interest expense                          | \$(4,781)              | \$ 1,403  | \$(3,378) |
| Net change in net interest income               | \$ 1,846               | \$(1,018) | \$ 828    |

|   | Period Ended March 31, |         |           |
|---|------------------------|---------|-----------|
|   | 2008 vs 2007           |         |           |
|   | Increase (Decrease)    |         |           |
|   | Due to                 |         |           |
|   | Rate                   | Volume  | Total     |
| Loans (taxable)                                 | \$(1,359)              | \$ 787  | \$( 572)  |
| Loans (tax-free)                                | (11)                   | 199     | 188       |
| Investment securities (taxable)                 | 470                    | 93      | 563       |
| Investment securities (tax-free)                | (82)                   | 11      | (71)      |
| Time deposits with banks and federal funds sold | 0                      | (17)    | (17)      |
| Total interest income                           | \$ (982)               | \$1,073 | \$ 91     |
| Deposits  | \$ (922)               | \$(147) | \$(1,069) |
| Borrowed funds                                  | 272                    | 451     | 723       |
| Total interest expense                          | \$ (650)               | \$ 304  | \$( 346)  |
| Net change in net interest income               | \$ (332)               | \$ 769  | \$ 437    |

(13)

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### Other Income and Expenses:

Other income in the first three months of 2009 increased \$216,000 in comparison to the same period of 2008. Service charges and fees decreased \$6,000 compared to the prior period. Income from service charges on deposits decreased \$42,000, or 6%, in comparison to the same period of last year. Other fee income increased \$36,000, or 6%. Net gains from asset sales increased \$222,000 comprised of a \$340,000 increase in gains on residential mortgage loans to reduce the risk to rising rates and a \$118,000 decrease in security gains as securities were sold to restructure the portfolio and to generate liquidity to meet loan demand.

Other expenses increased \$546,000 or 9% for the period ended March 31, 2009 compared to the same period of the previous year. Salaries and Benefits costs added \$243,000, or 8% in comparison to the first three months of 2008 due to additional staff and merit increases. Occupancy and equipment costs increased \$59,000, or 6%, data processing expenses increased \$18,000, or 4%, FDIC insurance expense increased \$145,000, or 153%, due to increased premiums, bank shares tax expense increased \$47,000, or 28%, and other operating expenses increased \$34,000, or 3%.

### 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 FASB 115, "Accounting for Certain Investments in Debt and Equity Securities."

### 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               | \$1,344 | \$1,909 |
| Add (Deduct):                             |         |         |
| Tax effect of non-taxable interest income | (622)   | (472)   |
| Tax effect of other tax free income       | (80)    | (83)    |
| Non-deductible interest expense           | 61      | 69      |
| Tax benefit from stock options exercised  | 0       | (3)     |
| Deferred tax benefits                     | (7)     | (6)     |
| Other items, net                          | 19      | 10      |
| Income tax expense                        | \$ 715  | \$1,424 |

### 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.

On February 27, 2009, The Board of Directors of the FDIC voted to amend the restoration plan for the Deposit Insurance Fund ("DIF"). The FDIC Board also took action to ensure the continued strength of the insurance fund by imposing a special assessment on insured institutions of 20

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basis points, implementing changes to the risk-based assessment system, and setting rates beginning the second quarter of 2009. Under the restoration plan approved in October 2008, the FDIC Board set a rate schedule to raise the DIF reserve ratio to 1.15 percent within five years. The February 27, 2009 restoration plan amendment action extends the restoration plan horizon to seven years in recognition of the current significant strains on banks and the financial system and the likelihood of a severe recession. 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

(14)

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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 an interim rule imposing a 20 basis point emergency special assessment on the industry on June 30, 2009. The assessment is to be collected on September 30, 2009. For the bank, based upon our deposit levels at March 31, 2009, the additional amount of 2009 FDIC insurance expense related to this special assessment, if imposed, would be approximately \$1,900,000. However, this proposed assessment is subject to regulatory change that could result in greater or lesser amounts. The interim rule would also permit the FDIC Board to impose an emergency special assessment after June 30, 2009, of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance. If this emergency special assessment is imposed, it would add an additional \$950,000 to the bank's 2009 FDIC insurance expense (based upon deposit levels as of March 31, 2009).

### Securities:

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

|  | March 31, 2009     |               | December 31, 2008  |               |
|--|--------------------|---------------|--------------------|---------------|
|  | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| U.S. Treasury securities and obligations of U.S. government agencies | \$16,557           | \$16,557      | \$ 32,233          | \$ 32,233     |
| Obligations of state & political subdivisions                        | 105,393            | 105,419       | 101,451            | 101,417       |
| Collateralized mortgage obligations                                  | 59,753             | 59,753        | 61,063             | 61,063        |
| Mortgage-backed securities   | 29,034             | 29,034        | 30,061             | 30,061        |
| Corporate debt securities  | 10,674             | 10,674        | 21,926             | 21,926        |
| Equity securities and mutual funds                                   | 985                | 985           | 974                | 974           |
| Total  | \$222,396          | \$222,422     | \$247,708          | \$247,674     |

(15)

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The following summarizes the amortized cost, approximate fair value, gross unrealized holding gains, and gross unrealized holding losses at March 31, 2009 of the company's Investment Securities classified as available-for-sale (in thousands):

|   | March 31, 2009    |   |  |                  |
|---|-------------------|---|--|------------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Holding<br>Gains | Gross<br>Unrealized<br>Holding<br>Losses | Fair<br>Value    |
| U.S. Treasury securities and obligations of U.S. government agencies: | \$ 18,713         | \$ 188                                  | \$ 2,344                                 | \$ 16,557        |
| Obligations of state and political subdivisions:                      | 109,875           | 1,049                                   | 7,361                                    | 103,563          |
| Collateralized mortgage obligations:                                  |                   |   |  |                  |
| Mortgage-backed securities:   | 66,870            | 1,451                                   | 8,568                                    | 59,753           |
| Corporate debt securities:  | 27,555            | 1,479                                   | 0  | 29,034           |
| Equity securities and mutual funds:                                   | 39,660            | 0                                       | 28,986                                   | 10,674           |
|   | 1,010             | 0                                       | 25                                       | 985              |
| <b>Total</b>  | <b>\$263,683</b>  | <b>\$4,167</b>                          | <b>\$47,284</b>                          | <b>\$220,566</b> |

The following summarizes the amortized cost, approximate fair value, gross unrealized holding gains, and gross unrealized holding losses at March 31, 2009 of the company's Investment Securities classified as held-to-maturity (dollars in thousands):

|  | March 31, 2009    |   |  |                 |
|--|-------------------|---|--|-----------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Holding<br>Gains | Gross<br>Unrealized<br>Holding<br>Losses | Fair<br>Value   |
| Obligations of state and political subdivisions: |                   |   |  |                 |
|  | \$ 1,830          | \$ 26                                   | \$ 0                                     | \$ 1,856        |
| <b>Total</b>                                     | <b>\$1,830</b>    | <b>\$ 26</b>                            | <b>\$ 0</b>                              | <b>\$ 1,856</b> |

The following table shows the amortized cost and approximate fair value of the company's debt securities at March 31, 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 |           | Held-to-maturity |         |
|-------------------------------------|---------------------|-----------|------------------|---------|
|                                     | Amortized           | Fair      | Amortized        | Fair    |
|                                     | Cost                | Value     | Cost             | Value   |
| Amounts maturing in:                |                     |           |                  |         |
| One year or less                    | \$ 1,008            | \$ 1,018  | \$ 0             | \$ 0    |
| After one year through five years   | 2,890               | 2,325     | 0                | 0       |
| After five years through ten years  | 9,566               | 9,004     | 0                | 0       |
| After ten years                     | 154,784             | 118,447   | 1,830            | 1,856   |
| Collateralized mortgage obligations | 66,870              | 59,753    | 0                | 0       |
| Mortgage-backed securities          | 27,555              | 29,034    | 0                | 0       |
| Total                               | \$262,673           | \$219,581 | \$1,830          | \$1,856 |

(16)

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Gross proceeds from the sale of investment securities for the periods ended March 31, 2009 and 2008 were \$9,141,563 and \$51,579,535 respectively with the gross realized gains being \$527,247 and \$698,277 respectively, and gross realized losses being \$0 and \$53,562 respectively.

At March 31, 2009 and 2008, investment securities with a carrying amount of \$163,471,053 and \$177,925,125 respectively, were pledged as collateral to secure public deposits and for other purposes.

### Loans:

The following table sets forth detailed information concerning the composition of the company's loan portfolio as of the dates specified (in thousands):

|  | March 31, 2009 |       | December 31, 2008 |       |
|--|----------------|-------|-------------------|-------|
|  | Amount         | %     | Amount            | %     |
| Real estate loans, secured by residential properties                       | \$198,777      | 20.2  | \$169,358         | 17.5  |
| Real estate loans, secured by nonfarm, nonresidential properties           |                |       |                   |       |
|  | 391,578        | 39.7  | 420,983           | 43.6  |
| Commercial & industrial loans  | 221,032        | 22.4  | 221,026           | 22.9  |
| Loans to individuals for household, family and other personal expenditures |                |       |                   |       |
|  | 133,268        | 13.5  | 119,501           | 12.4  |
| Loans to state and political subdivisions                                  | 41,098         | 4.2   | 34,027            | 3.5   |
| All other loans, including overdrafts                                      | 342            | 0.0   | 413               | 0.1   |
| Total Gross Loans  | \$986,095      | 100.0 | \$965,308         | 100.0 |
| Less: Allow. for Credit Losses   | (10,382)       |       | (8,254)           |       |
| Less: Unearned Discount  | (359)          |       | (380)             |       |
| Net Loans  | \$975,354      |       | \$956,674         |       |

The following table sets forth certain information with respect to the company's allowance for credit losses and charge-offs (in thousands)

|                             | Three months Ended | Year to date Ended |
|-----------------------------|--------------------|--------------------|
|                             | March 31, 2009     | December 31, 2008  |
| Balance, January 1          | \$9,150            | \$7,569            |
| Recoveries Credited         | 44                 | 208                |
| Losses Charged              | (376)              | (1,327)            |
| Provision for Credit Losses | 2,460              | 2,700              |
| Balance at End of Period    | \$11,278           | \$9,150            |

Allocated as:

Allowance for off-balance sheet commitments

\$ 896

\$ 896

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|                             |          |         |
|-----------------------------|----------|---------|
| Allowance for credit losses | 10,382   | 8,254   |
| Balance at End of Period    | \$11,278 | \$9,150 |

(17)

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The following table presents information about the company's non-performing assets for the periods indicated (in thousands):

|   | March 31, 2009 | December 31, 2008 |
|---|----------------|-------------------|
| Nonaccrual loans:                                     |                |                   |
| Impaired  | \$32,310       | \$22,087          |
| Other   | 174            | 176               |
| Loans past due 90 days or more and still accruing     | 2,295          | 1,151             |
| Total non-performing loans                            | 34,779         | 23,414            |
| Other Real Estate Owned                               | 2,308          | 2,308             |
| Total non-performing assets                           | \$37,087       | \$25,722          |
| <br>  |                |                   |
| Non-performing loans as a percentage of gross loans   | 3.5%           | 2.4%              |
| Non-performing assets as a percentage of total assets | 2.8%           | 2.0%              |

Non-performing assets are comprised of non-accrual loans and loans past due 90 days or more and still accruing, and other real estate owned. Loans are placed in nonaccrual status when management believes that the collection of interest or principal is doubtful, or generally when a default of interest or principal has existed for 90 days or more, unless such loan is fully secured and in the process of collection. When interest accrual is discontinued, interest credited to income in the current year is reversed and interest accrued in prior years is charged against the allowance for credit losses. Any payments received are applied, first to the outstanding loan amounts, then to the recovery of any charged-off loan amounts. Any excess is treated as a recovery of lost interest. Nonaccrual loans at March 31, 2009 were comprised of twelve credits totaling \$32.5 million. Declining real estate values are placing significant pressure on the collateral requirements, and management projects that losses on these credits could approximate \$10 million if conditions do not improve.

### Subsequent Events:

The company disclosed the following events on Form 8-K filed April 29, 2009:

- Other-than-temporary impairment of certain pooled trust preferred investment securities:

The Registrant expects to record non-cash charges for the second quarter of 2009 related to an other-than-temporary impairment of certain pooled trust preferred investment securities. The other-than-temporary impairment charge is expected to be approximately \$240,000.

As previously disclosed, the Registrant, like other financial institutions, maintains a portfolio of investment securities, which may from time to time include pooled trust preferred securities, both as a means to deploy assets and as a source of liquidity.

The Registrant has concluded that a \$3.0 million issue of these pooled trust preferred securities has become other-than-temporarily impaired based upon its analysis of estimated cash flows in accordance with United States generally accepted accounting principles ("GAAP"). The \$240,000 impairment charge represents the credit component of the price deterioration of the security, while the remainder of the fair value deficiency will be recorded in Other Comprehensive Income in accordance with GAAP.

- Increase in Loan Loss Reserve:

The Registrant recorded a provision for loan losses of \$7.25 million for the second quarter of 2009, compared to a provision of \$2,460,000 in the first quarter of 2009. As a result, the total provision for loan losses for the year ending December 31, 2009 is now expected to be approximately \$18.4 million. The expected increase in the provision for loan losses is a result of a variety of factors including current and expected economic conditions, as well as an increase in non-performing assets and net charge-offs primarily in the commercial real estate portfolio.

(18)

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Provision for Credit Losses:

The provision for credit losses varies from year to year based on management's evaluation of the adequacy of the allowance for credit losses in relation to the risks inherent in the loan portfolio. In its evaluation, management considers credit quality, changes in loan volume, composition of the loan portfolio, past experience, delinquency trends, and the economic condition. Consideration is also given to examinations performed by regulatory authorities and the company's independent accountants. A monthly provision of \$120,000 was credited to the allowance during the first three months of 2009 plus a special insertion of \$2.1 million as a result of deficient collateral valuation on one credit which was received in April, 2009. A monthly provision of \$100,000 was recognized during the first three months of 2008. The ratio of the loan loss reserve to total loans at March 31, 2009 and 2008 was 1.05% and 0.68%, respectively.

The Registrant recorded a provision for loan losses of \$7.25 million for the second quarter of 2009, compared to a provision of \$2,460,000 in the first quarter of 2009. As a result, the total provision for loan losses for the year ending December 31, 2009 is now expected to be approximately \$18.4 million. The expected increase in the provision for loan losses is a result of a variety of factors including current and expected economic conditions, as well as an increase in non-performing assets and net charge-offs primarily in the commercial real estate portfolio.

Asset/Liability Management, Interest Rate Sensitivity and Inflation

The major objectives of the company's asset and liability management are to (1) manage exposure to changes in the interest rate environment to achieve a neutral interest sensitivity position within reasonable ranges, (2) ensure adequate liquidity and funding, (3) maintain a strong capital base, and (4) maximize net interest income opportunities. The bank manages these objectives through its Senior Management and Asset and Liability Management Committees. Members of the committees meet regularly to develop balance sheet strategies affecting the future level of net interest income, liquidity and capital. Items that are considered in asset and liability management include balance sheet forecasts, the economic environment, the anticipated direction of interest rates and the bank's earnings sensitivity to changes in these rates.

The company analyzes its interest sensitivity position to manage the risk associated with interest rate movements through the use of gap analysis and simulation modeling. Because of the limitations of the gap reports, the bank uses simulation modeling to project future net interest income streams incorporating the current "gap" position, the forecasted balance sheet mix, and the anticipated spread relationships between market rates and bank products under a variety of interest rate scenarios.

Economic conditions affect financial institutions, as they do other businesses, in a number of ways. Rising inflation affects all businesses through increased operating costs but affects banks primarily through the manner in which they manage their interest sensitive assets and liabilities in a rising rate environment. Economic recession can also have a material effect on financial institutions as the assets and liabilities affected by a decrease in interest rates must be managed in a way that will maximize the largest component of a bank's income, that being net interest income. Recessionary periods may also tend to decrease borrowing needs and increase the uncertainty inherent in the borrowers' ability to pay previously advanced loans. Additionally, reinvestment of investment portfolio maturities can pose a problem as attractive rates are not as available. Management closely monitors the interest rate risk of the balance sheet and the credit risk inherent in the loan portfolio in order to minimize the effects of fluctuations caused by changes in general economic conditions.

Liquidity

The term liquidity refers to the ability of the company to generate sufficient amounts of cash to meet its cash-flow needs. Liquidity is required to fulfill the borrowing needs of the bank's credit customers and the withdrawal and maturity requirements of its deposit customers, as well as to meet other financial commitments.

The short-term liquidity position of the company is strong as evidenced by \$17,536,000 in cash and cash equivalents. A secondary source of liquidity is provided by the investment portfolio with \$28 million or 10% of the portfolio maturing or expected to provide cash flow within one year through maturities, projected calls or principal reductions.

The company's focus is on retail deposits as a source of funds, although short-term needs can be funded with municipal deposits. The bank has the ability to sell Federal funds to invest excess cash; however, the bank can also borrow in the Federal Funds market to meet temporary liquidity needs. Other sources of potential liquidity include Federal Home Loan Bank advances, the Federal Reserve Discount Window, CDARS deposits and the Brokered CD market.



Capital Management

A strong capital base is essential to the continued growth and profitability of the company and in that regard the maintenance of appropriate levels of capital is a management priority. The company's principal capital planning goals are to provide an adequate return to shareholders while retaining a sufficient base from which to provide for future growth, while at the same time complying with all regulatory standards. As more fully described in Note 15 to the year end audited financial statements, regulatory authorities have prescribed specified minimum capital ratios as guidelines for determining capital adequacy to help insure the safety and soundness of financial institutions.

Total stockholders' equity decreased \$5,305,000 or 5% during the first three months of 2009 comprised of an increase in retained earnings in the amount of \$1,473,000 after paying cash dividends, \$889,000 from stock issued through Dividend Reinvestment, Stock Options awarded of \$159,000 and a \$7,826,000 decrease in other comprehensive income. Management believes that the \$43 million unrealized loss recorded as of March 31, 2009 represents "distressed" pricing levels and is a temporary event. As of March 31, 2009, the company has not recognized a loss on securities due to an Other-Than-Temporary-Impairment. During the same period of 2008, total stockholders' equity increased \$3,727,000, or 3%, comprised of an increase in retained earnings of \$2,458,000, after paying cash dividends, \$783,000 from stock issued through Dividend Reinvestment and Stock Option Plans and a \$486,000 increase in other comprehensive income. The total dividend payout during the first nine three of 2009 and 2008 represents \$.11 per share. Excluding the impact due to securities valuation, increases in core equity amounted to \$3,907,000 and \$3,241,000, respectively.

The Board of Governors of the Federal Reserve System and other various regulatory agencies have specified guidelines for purposes of evaluating a bank's capital adequacy. Currently, banks must maintain a leverage ratio of core capital to total assets at a prescribed level, namely 3%. In addition, bank regulators have issued risk-based capital guidelines. Under such guidelines, minimum ratios of core capital and total qualifying capital as a percentage of risk-weighted assets and certain off-balance sheet items of 4% and 8% are required. As of March 31, 2009, the bank met all capital requirements with a leverage ratio of 9.25% and core capital and total risk-based capital ratios of 9.82% and 10.71%, respectively. On a consolidated basis, the company's leverage ratio, core capital and total risk-based capital ratios at March 31, 2009 were 9.26%, 9.83% and 10.73%, respectively.

Part II Other Information

Item 6 – Exhibits.

|              |   |
|--------------|---|
| Exhibit 31.1 | Certification of Principal Executive Officer<br>Pursuant to Section 302 of the Sarbanes-Oxley Act |
| Exhibit 31.2 | Certification of Principal Financial Officer<br>Pursuant to Section 302 of the Sarbanes-Oxley Act |
| Exhibit 32.1 | Certification of Principal Executive Officer<br>Pursuant to Section 906 of the Sarbanes-Oxley Act |
| Exhibit 32.2 | Certification of Principal Financial Officer<br>Pursuant to Section 906 of the Sarbanes-Oxley Act |

(20)

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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.

Registrant: FIRST NATIONAL COMMUNITY BANCORP, INC

Date: July 9, 2009

By: /s/ J. David Lombardi  
J. David Lombardi, President/

Chief Executive Officer

Date: July 9, 2009

By: /s/ William Lance  
William Lance, Treasurer

Principal Financial Officer and

Principal Accounting Officer

(21)