FIRST NATIONAL COMMUNITY BANCORP INC
Form 10-Q
May 10, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

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. 000-53869

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

Pennsylvania (State or Other Jurisdiction of Incorporation or Organization)	23-2900790 (I.R.S. Employer Identification No.)
102 E. Drinker St., Dunmore, PA (Address of Principal Executive Offices)	18512 (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 | X | 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 | X |

Non-Accelerated Filer |__| Smaller reporting company |__|

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

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	16,308,108 shares
(Title of Class)	(Outstanding at May 7, 2010)

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PART I Financial Information

Item 1 – Financial Statements

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

	March 31, 2010 (UNAUDITED)	December 31, 2009 (AUDITED)
	(dollars in thousands, except share data)	
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$19,177	$24,189
Federal funds sold	61,050	62,175
Total cash and cash equivalents	80,227	86,364
Securities:		
Available-for-sale, at fair value	246,959	259,955
Held-to-maturity, at cost (fair value $1,824 on March 31, 2010 and $1,788 on December 31, 2009)	1,922	1,899
Federal Reserve Bank and FHLB stock, at cost	12,069	11,779
Net loans	920,302	927,324
Bank premises and equipment	20,750	20,667
Intangible Assets	9,914	9,928
Other assets	83,450	77,495
Total Assets	$1,375,593	$1,395,411
LIABILITIES		
Deposits:		
Demand – non-interest bearing	$79,266	$85,370
Interest bearing demand	344,055	352,631
Savings	93,663	86,455
Time ($100,000 and over)	236,540	238,839
Other time	299,959	308,313
Total deposits	1,053,483	1,071,608
Borrowed funds	190,696	194,367
Subordinated debentures	25,000	23,100
Other liabilities	13,723	15,203
Total Liabilities	$1,282,902	$1,304,278
SHAREHOLDERS' EQUITY		
Common Stock, $1.25 par value,		
Authorized: 50,000,000 shares		
Issued and outstanding:		
16,299,456 shares at March 31, 2010 and		
16,289,970 shares at December 31, 2009	$20,374	$20,362
Additional Paid-in Capital	61,224	61,190
Retained Earnings	28,813	26,854
Accumulated Other Comprehensive Income (Loss)	(17,720)	(17,273)
Total shareholders' equity	$92,691	$91,133
Total Liabilities and Shareholders’ Equity	$1,375,593	$1,395,411

Note: The balance sheet at December 31, 2009 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)

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

	For the Quarter Ended March 31,	
	2010	2009
	(dollars in thousands, except share data)	
Interest Income:		
Loans	$12,188	$13,358
Investments	3,073	3,492
Federal Funds Sold	36	0
Total interest income	15,297	16,850
Interest Expense:		
Deposits	4,032	4,145
Subordinated debt	539	0
Borrowed Funds	1,501	2,038
Total interest expense	6,072	6,183
Net Interest Income before Loan Loss Provision	9,225	10,667
Provision for credit losses	2,802	2,460
Net interest income	6,423	8,207
Other Income:		
Total other-than-temporary impairment losses	(31,428)	(47,285)
Portion of loss recognized in other comprehensive income (before taxes)	30,513	47,285
Net impairment losses	(915)	0
Service charges	650	687
Other Income	658	663
Gain on sale of:		
Loans	273	546
Securities	1,196	527
Other Real Estate	0	0
Total other income	1,862	2,423
Other expenses:		
Salaries & benefits	3,120	3,332
Occupancy & equipment	1,067	1,070
Advertising expense	225	240
Data processing expense	487	436
FDIC assessment	469	240
Bank shares tax	255	217
Expense of ORE	120	0
Credit for off-balance sheet commitments	(1,031)	0
Other	1,670	1,142
Total other expenses	6,382	6,677
Income before income taxes	1,903	3,953
Income tax expense (benefit)	(56)	715
NET INCOME	$1,959	$3,238
Basic earnings per share	$0.12	$0.20
Diluted earnings per share	$0.12	$0.20

Weighted average number of basic shares	16,294,291	16,064,455
Weighted average number of diluted shares	16,658,009	16,460,979

See notes to financial statements

(2)

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

	For the Three Months Ended March 31,	
	2010	2009
	(dollars in thousands)	
INCREASE (DECREASE) IN CASH EQUIVALENTS:		
Cash Flows From Operating Activities:		
Interest Received	$14,933	$16,544
Fees & Commissions Received	1,353	1,379
Interest Paid	(6,369)	(7,284)
Income Taxes Paid	0	(1,132)
Cash Paid to Suppliers & Employees	(10,214)	(8,528)
Net Cash Provided by Operating Activities	$(297)	$ 979
Cash Flows from Investing Activities:		
Securities available for sale:		
Proceeds from Sales prior to maturity	$24,687	$9,142
Proceeds from Calls prior to maturity	8,035	13,538
Purchases	(19,194)	(8,354)
Net (Increase)/Decrease in Loans to Customers	919	(19,878)
Capital Expenditures	(437)	(283)
Net Cash Provided/(Used) by Investing Activities	$14,010	$(5,835)
Cash Flows from Financing Activities:		
Net Increase/(Decrease) in Demand Deposits, Money Market Demand, NOW Accounts, and Savings Accounts	$(7,472)	$(10,764)
Net Increase/(Decrease) in Certificates of Deposit	(10,653)	24,912
Proceeds from issuance of Subordinated Debentures	1,900	0
Net Decrease in Borrowed Funds	(3,671)	(9,050)
Net Proceeds from Issuance of Common Stock Through Dividend Reinvestment	46	889
Dividends Paid	0	(1,766)
Net Cash Provided/(Used) by Financing Activities	$(19,850)	$4,221
Net Increase/(Decrease) in Cash and Cash Equivalents	$(6,137)	$(635)
Cash & Cash Equivalents at Beginning of Year	$86,364	$18,171
CASH & CASH EQUIVALENTS AT END OF PERIOD	$80,227	$17,536

(Continued)
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FIRST NATIONAL COMMUNITY BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOW (CONTINUED)
(UNAUDITED)

	For the Three Months Ended March 31,	
	2010	2009
	(dollars in thousands)	
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Income	$1,959	$ 3,238
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Amortization (Accretion), Net	(760)	(952)
Equity in trust	(1)	(2)
Depreciation and Amortization	441	458
Provision for Probable Credit Losses	2,802	2,460
Provision for Deferred Taxes	(22)	(56)
Gain on Sale of Loans	(272)	(546)
Gain on Sale of Investment Securities	(1,196)	(527)
Impairment losses on Investment Securities	915	0
Increase/(Decrease) in Taxes Payable	8	(505)
Decrease in Interest Receivable	397	646
Decrease in Interest Payable	(298)	(1,101)
Increase in Prepaid Expenses and Other Assets	(3,251)	(1,596)
Increase in Accrued Expenses and Other Liabilities	(1,019)	(538)
Total Adjustments	$(2,256)	$(2,259)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$(297)	$ 979

See notes to financial statements
(4)

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For The Three Months Ended March 31, 2010
(In thousands, except share data)
(UNAUDITED)

	COMP-REHEN-SIVE INCOME	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADD'L PAID-IN CAPITAL	RETAINED EARNINGS	ACCUM-ULATED OTHER COMP-REHEN-SIVE INCOME/ (LOSS)	TOTAL
BALANCES, DECEMBER 31, 2009		16,289,970	$20,362	$61,190	$26,854	$(17,273)	$91,133
Comprehensive Income:							
Net income for the period	1,959				1,959		1,959
Other comprehensive income, net of tax:							
Unrealized loss on securities available-for-sale net of deferred tax benefit of $3,149	(6,113)						
Noncredit related gains on securities not expected to be sold, net of deferred taxes of $2,973	5,771						
Reclassification adjustment for gain or loss included in income (tax effect of $407)	789						
Total other comprehensive loss, net of tax	(447)					(447)	(447)
Comprehensive Income	1,512						
Issuance of Common Stock through Dividend Reinvestment		9,486	12	34			46
BALANCES, MARCH 31, 2010		16,299,456	$20,374	$61,224	$28,813	$(17,720)	$92,691

See notes to financial statements

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN
STOCKHOLDERS' EQUITY
For The Three Months Ended March 31, 2009
(In thousands, except share data)
(UNAUDITED)

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

See notes to financial statements

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 2009 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, 2010 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, 2009.

(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:

	March 31, 2010			March 31, 2009		
	(dollars in thousands)					
	Pre-tax Amount	Tax (Expense) Benefit	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	$(9,263)	$3,150	$(6,113)	$(12,751)	$4,398	$(8,353)
Noncredit related losses on securities not expected to be sold	8,744	(2,973)	5,771	0	0	0
Less: reclassification adjustment for gain or loss realized in net income	1,195	(406)	789	711	(184)	527
Net unrealized gains (losses)	$676	$(229)	$447	$(12,040)	$4,214	$(7,826)
Other comprehensive income (loss)	$676	$(229)	$447	$(12,040)	$4,214	$(7,826)

(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 16,294,291 and 16,064,455 for the periods ending March 31, 2010 and 2009, 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 16,658,009 and 16,460,979 for the periods ending March 31, 2010 and 2009, 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.

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:

	Three months ended March 31,			
	2010		2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at the beginning of the period	366,248	$12.18	325,134	$12.36
Granted	0		74,600	10.81
Exercised	0		0	
Forfeited	(25,300)	11.00	0	
Outstanding at the end of the period	340,948	12.26	399,734	12.07
Options exercisable at March 31,	340,948	12.26	325,134	12.36
Weighted average fair value of options granted during the period	---	--	---	2.13

Information pertaining to options outstanding at March 31, 2010 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$5.19-$23.13	340,948	5.2 years	$12.26	340,948	$12.26

(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 March 31, 2010 and December 31, 2009, our FHLB stock totaled $10.9 million.

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;

(8)

- 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 March 31, 2010. 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 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, 2009.

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, 2010 and 2009. 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.

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, 2010, the company had 21 full-service branch banking offices in its principal market area in Lackawanna, Luzerne, Wayne and Monroe Counties, Pennsylvania. At March 31, 2010, the company had 295 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
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
Dunmore - Wheeler Avenue	December 2009

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 Wealth Management Services, our customers are able to access alternative products such as mutual funds, bonds, equities and annuities directly from our FNCB Wealth Management 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:

Net income for the first three months of 2010 amounted to $1.959 million a decrease of $1.279 million, or 39%, when compared to $3.238 million for the same period of the previous year. The decrease is primarily due to a decrease in interest income of $1.553 million which was partially offset by a $771,000 reduction of recoverable income taxes. Other income decreased $561,000 primarily due to a $915,000 impairment charge on securities offset by a

$396,000 increase in the gain on asset sales. Other expenses decreased $295,000 over the same period of last year due to $1.031 million decrease in the reserve for off-balance sheet commitments, offset by an increase in FDIC insurance premiums of $229,000 and an increase in expenses of ORE of $120,000.

(10)

RESULTS OF OPERATIONS
Net Interest Income:

The company's primary source of revenue is net interest income which totaled $9.225 million and $10.667 million (before the provision for credit losses) during the first three months of 2010 and 2009, respectively. The year to date net interest margin (tax equivalent) decreased forty-nine basis points to 3.25% in 2010 compared to 2009 comprised of a fifty-six basis point decrease in the yield earned on earning assets which was offset by a sixteen basis point decrease in the cost of interest-bearing liabilities. Excluding investment leveraging transactions, the 2009 margin would be 3.27% which is sixty-two basis points lower than the 3.87% recorded during the first three months of last year.

Earning assets decreased $20 million to $1.257 billion during the first three months of 2010 and total 91.4% of total assets, comparable to the 91.5% 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:

	Three months ended March 31, 2010			Three months ended March 31, 2009		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans (taxable)	$859,048	$11,560	5.40%	$906,082	$12,750	5.65%
Loans (tax-free) (1)	56,223	628	6.87	53,362	608	7.01
Investment securities (taxable)	174,493	1,673	3.84	177,746	2,272	5.11
Investment securities (tax-free)(1)	121,479	1,400	7.09	108,663	1,220	6.91
Time deposits with banks and federal funds sold	56,555	36	0.25	38	0	0.33
Total interest-earning assets	1,267,798	15,297	5.18%	1,245,891	16,850	5.74%
Non-interest earning assets	117,710			81,651		
Total Assets	$1,385,508			$1,327,542		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Deposits	$983,592	$4,032	1.66%	$871,625	$ 4,145	1.93%
Borrowed funds	216,945	2,040	3.76	264,729	2,038	3.08
Total interest-bearing liabilities	1,200,537	6,072	2.04%	1,136,354	6,183	2.20%
Other liabilities and shareholders' equity	184,971			191,188		
Total Liabilities and Shareholders' Equity	$1,385,508			$1,327,542		
Net interest income/rate spread		$9,225	3.14%		$10,667	3.54%
Net yield on average interest-earning assets			3.25%			3.74%

Interest-earning assets as a percentage of interest-bearing liabilities	106%	110%

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

(11)

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, 2010 vs 2009			Period Ended March 31, 2009 vs 2008		
	Increase (Decrease) Due to		Increase (Decrease) Due to	Increase (Decrease) Due to		Increase (Decrease) Due to
	Rate	Volume	Total	Rate	Volume	Total
Loans (taxable)	$(517)	$(673)	$(1,190)	$(2,796)	$611	$(2,185)
Loans (tax-free)	(13)	33	20	(11)	63	52
Investment securities (taxable)	(594)	(5)	(599)	(448)	(357)	(805)
Investment securities (tax-free)	36	144	180	320	68	388
Time deposits with banks and federal funds sold	(9)	45	36	0	0	0
Total interest income	$(1,097)	$(456)	$(1,553)	$(2,935)	$385	$(2,550)
Deposits	$(552)	$439	$(113)	$(3,142)	$426	$(2,716)
Borrowed funds	577	(575)	2	(1,639)	977	(662)
Total interest expense	$25	$(136)	$(111)	$(4,781)	$1,403	$(3,378)
Net change in net interest income	$(1,122)	$(320)	$(1,442)	$1,846	$(1,018)	$828

Other Income and Expenses:

Other income in the first three months of 2010 decreased $561,000 in comparison to the same period of 2009 primarily due to a $915,000 other-than-temporary impairment loss on securities. Service charges and fees decreased $42,000 compared to the prior period. Income from service charges on deposits decreased $37,000, or 5%, in comparison to the same period of last year. Other fee income decreased $5,000, or 1%. Net gains from asset sales increased $396,000 comprised of a $669,000 increase in security gains as securities were sold to restructure the portfolio and to generate liquidity to meet loan demand offset partially by a $273,000 decrease in gains on residential mortgage loans.

Other expenses decreased $295,000 or 4% for the period ended March 31, 2010 compared to the same three month period of the previous year primarily due to a decrease in the provision for off-balance sheet commitments of $1.031 million. Salaries and Benefits costs decreased $212,000 in comparison to the first three months of 2009, and data processing expenses decreased $51,000, or 12%. FDIC insurance expense increased $229,000, or 95%, due to increased premiums, bank shares tax expense increased $38,000, or 18%, expenses of other real estate increased $120,000 and other operating expenses increased $528,000.

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.

(12)

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:

	2010	2009
Provision at statutory rate	$647	$1,344
Add (Deduct):		
Tax effect of non-taxable interest income	(689)	(622)
Tax effect of other tax free income	(67)	(80)
Non-deductible interest expense	51	61
Deferred tax benefits	(8)	(7)
Other items, net	10	19
Income tax expense	$(56)	$715

Federal Deposit Insurance Corporation ("FDIC") Activity:

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.

Prior to the final rule, most banks were in the best risk category and paid anywhere from 12 cents per $100 of deposits to 14 cents per $100 for insurance. Beginning April 1, 2009, banks in this category began paying initial base rates ranging from 12 cents per $100 to 16 cents per $100 on an annual basis. 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 revenu