FIRST NATIONAL COMMUNITY BANCORP INC
Form 10-Q
August 07, 2009

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 **June 30, 2009**

OR

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

For the transition period from _____________ to _____________

Commission File No. 333-24121

FIRST NATIONAL COMMUNITY BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	23-2900790
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

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

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

____

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES |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 12-b-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	**16,182,563 shares**
(Title of Class)	(Outstanding at August 4, 2009)

FIRST NATIONAL COMMUNITY BANCORP, INC.

INDEX

(ii)

FIRST NATIONAL COMMUNITY BANCORP, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in thousands)

	June 30, 2009 (UNAUDITED)	December 31, 2008 (AUDITED)
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 23,234	$ 18,171
Federal funds sold	36,600	0
Total cash and cash equivalents	59,834	18,171
Securities:		
Available-for-sale, at fair value	223,671	245,900
Held-to-maturity, at cost (fair value $1,837 on June 30, 2009 and $1,774 on December 31, 2008)	1,853	1,808
Federal Reserve Bank and FHLB stock, at cost	11,515	11,087
Net loans	950,206	956,674
Bank premises and equipment	17,459	17,785
Intangible Assets	9,901	9,781
Other assets	53,777	52,553
Total Assets	$1,328,216	$1,313,759
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Demand – non-interest bearing	$ 78,670	$ 79,760
Interest bearing demand	296,894	302,058
Savings	81,217	79,526
Time ($100,000 and over)	267,550	191,052
Other time	270,603	300,496
Total deposits	994,934	952,892
Borrowed funds	220,811	245,197
Other liabilities	12,307	15,328
Total Liabilities	$1,228,052	$1,213,417
Shareholders' equity:		
Common Stock, $1.25 par value,		

Authorized: 50,000,000 shares

Issued and outstanding:

16,179,563 shares at June 30, 2009 and

16,047,928 shares at December 31, 2008

	$ 20,224	$ 20,060
Additional Paid-in Capital	60,692	59,591
Retained Earnings	39,827	40,892
Accumulated Other Comprehensive Income (Loss)	(20,579)	(20,201)
Total shareholders' equity	$ 100,164	$ 100,342
Total Liabilities and Shareholders’ Equity	$1,328,216	$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)

FIRST NATIONAL COMMUNITY BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Interest Income:				
Loans	$ 13,039	$ 14,538	$ 26,397	$ 30,029
Investments	3,290	3,544	6,782	7,453
Federal Funds Sold	13	5	13	5
Total interest income	16,342	18,087	33,192	37,487
Interest Expense:				
Deposits	4,322	6,038	8,467	12,899
Borrowed Funds	1,841	2,267	3,879	4,967
Total interest expense	6,163	8,305	12,346	17,866
Net Interest Income before Loan Loss Provision	10,179	9,782	20,846	19,621
Provision for credit losses	7,250	550	9,710	850
Net interest income	2,929	9,232	11,136	18,771
Other Income:				
Service charges	722	791	1,410	1,520
Other Income	584	654	1,247	1,281
Gain / (Loss) on sale of:				
Loans	462	94	1,007	300
Securities	(84)	68	443	713
Other Real Estate	0	0	0	0
Total other income	1,684	1,607	4,107	3,814
Other expenses:				
Salaries & benefits	2,984	3,134	6,316	6,223
Occupancy & equipment	1,011	993	2,081	2,004
Advertising expense	240	240	480	480
Data processing expense	430	417	866	835
FDIC assessment	1,192	95	1,432	361
Bank shares tax	215	170	432	327
Other	1,271	1,317	2,413	2,267
Total other expenses	7,343	6,366	14,020	12,497
Income before income taxes	(2,730)	4,473	1,223	10,088
Income tax expense	(514)	964	201	2,388
NET INCOME (LOSS)	$ (2,216)	$ 3,509	$ 1,022	$ 7,700
Basic earnings (loss) per share	$ (0.14)	$ 0.22	$ 0.06	$ 0.49
Diluted earnings (loss) per share	$ (0.14)	$ 0.22	$ 0.06	$ 0.48
Weighted average number of basic shares	16,158,640	15,827,339	16,111,808	15,793,330
Weighted average number of diluted shares	16,158,640	16,167,453	16,508,354	16,140,183

See notes to financial statements

(2)

FIRST NATIONAL COMMUNITY BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

SIX MONTHS ENDED JUNE 30, 2009 AND 2008

(UNAUDITED)

	June 30, 2009	June 30, 2008
	(Dollars in thousands)	
INCREASE (DECREASE) IN CASH EQUIVALENTS:		
Cash Flows From Operating Activities:		
Interest Received	$ 32,195	$ 37,139
Fees & Commissions Received	2,719	2,833
Interest Paid	(13,414)	(19,620)
Income Taxes Paid	(1,861)	(2,152)
Cash Paid to Suppliers & Employees	(16,000)	(11,792)
Net Cash Provided by Operating Activities	$ 3,639	$ 6,407
Cash Flows from Investing Activities:		
Securities available for sale:		
Proceeds from Sales prior to maturity	$ 12,378	$ 51,580
Proceeds from Calls prior to maturity	22,531	26,235
Purchases	(11,371)	(52,468)
Net Increase in Loans to Customers	(1,754)	(42,224)
Capital Expenditures	(434)	(2,202)
Net Cash Provided/(Used) by Investing Activities	$ 21,350	$(19,079)
Cash Flows from Financing Activities:		
Net Decrease in Demand Deposits, Money Market Demand, NOW Accounts, and Savings Accounts	$(4,562)	$(5,545)
Net Increase/(Decrease) in Certificates of Deposit	46,603	(20,259)
Net Increase/(Decrease) in Borrowed Funds	(24,386)	43,382
Net Proceeds from Issuance of Common Stock Through Dividend Reinvestment	1,106	1,382
Net Proceeds from Issuance of Common Stock – Stock Option Plans	0	153
Dividends Paid	(2,087)	(3,473)
Net Cash Provided/(Used) by Financing Activities	$ 16,674	$ 15,640
Net Increase/(Decrease) in Cash and Cash Equivalents	$ 41,663	$ 2,968
Cash & Cash Equivalents at Beginning of Year	$ 18,171	$ 24,735
CASH & CASH EQUIVALENTS AT END OF PERIOD	$ 59,834	$ 27,703

(Continued)

(3)

FIRST NATIONAL COMMUNITY BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOW (CONTINUED)

SIX MONTHS ENDED JUNE 30, 2009 AND 2008

(UNAUDITED)

	2009	2008
	(Dollars in thousands)	
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Income	$ 1,022	$7,700
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Amortization (Accretion), Net	(1,921)	(1,757)
Equity in trust	(3)	(5)
Depreciation and Amortization	907	889
Provision for Probable Credit Losses	9,710	850
Provision for Deferred Taxes	(112)	(105)
Gain on Sale of Loans	(1,007)	(300)
Gain on Sale of Investment Securities	(443)	(713)
Increase/(Decrease) in Taxes Payable	(1,692)	(404)
Decrease in Interest Receivable	924	1,408
Decrease in Interest Payable	(1,068)	(1,755)
Increase in Prepaid Expenses and Other Assets	(2,576)	(607)
Increase/(Decrease) in Accrued Expenses and Other Liabilities	(102)	1,206
Total Adjustments	$ 2,617	$(1,293)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 3,639	$6,407

See notes to financial statements

(4)

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For The Six Months Ended June 30, 2009
(RESTATED)
(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, 2008		16,047,928	$20,060	$59,591	$40,892	$(20,201)	$100,342
Comprehensive Income:							
Net income for the period	1,022				1,022		1,022
Other comprehensive income, net of tax:							
Unrealized loss on securities available-for-sale, net of deferred income tax benefit of $358	(666)						
Reclassification adjustment for gain or loss included in income, net of deferred income taxes of $155	288						
Total other comprehensive income/(loss), net of tax	(378)					(378)	(378)
Comprehensive Income/(Loss)	644						
Stock Options Awarded				159			159
Issuance of Common Stock through Dividend Reinvestment		131,635	164	942			1,106
Cash dividends paid, $0.13 per share					(2,087)		(2,087)

BALANCES, JUNE 30, 2009	16,179,563	$20,224	$60,692	$39,827	$(20,579)	$100,164

See notes to financial statements

(5)

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 June 30, 2009 and for all periods presented have been made.

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

(2) 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 16,111,808 and 15,793,330 for the periods ending June 30, 2009 and 2008, respectively.

Diluted earnings per share have been computed by dividing net income (the numerator) by the weighted average number of common shares and options outstanding (the denominator) for the period. Such shares amounted to 16,508,354 and 16,140,183 for the periods ending June 30, 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:

	Six months ended June 30,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at the beginning of the period	325,134	$12.36	360,694	$11.93
Granted	74,600	10.81	0	
Exercised	0		(25,750)	5.93
Forfeited	(3,061)	18.80	(2,061)	19.72
Outstanding at the end of the period	396,673	12.02	332,883	12.34
Options exercisable at June 30,	322,073	12.30	332,883	12.34

Weighted average fair value of options granted during the period	2.13	---

(6)

Information pertaining to options outstanding at June 30, 2009 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	396,673	5.8 years	\$12.02	322,073	\$12.30

(4) Investment Securities: During the second quarter of 2009, First National Community Bancorp, Inc. adopted FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairment" which requires that credit related other-than-temporary impairment on debt securities be recognized in earnings while noncredit related other-than-temporary impairment on debt securities not expected to be sold be recognized in other comprehensive income ("OCI"). As a result, in the second quarter of 2009 we recorded a \$382,000 other-than-temporary charge. This charge includes \$242,000 in credit related other-than-temporary impairment on a trust preferred collateralized debt obligation and \$140,000 recorded on a private label mortgage-backed security. All of the securities for which other-than-temporary impairment was recorded were classified as available for sale securities. Additionally, \$3.3 million in noncredit related other-than-temporary impairment was recorded in OCI on the two securities which were classified as impaired.

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market. We evaluate our intent and ability to hold debt securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, the risk of future other-than-temporary impairment may be influenced by additional bank failures, prolonged recession in the U.S. economy, changes in real estate values, interest deferrals, and whether the federal government provides assistance to financial institutions. Our pooled trust preferred collateralized debt obligations are beneficial interests in securitized financial assets within the scope of EITF 99-20, and are therefore evaluated for other-than-temporary impairment using management's best estimate of future cash flows. If these estimated cash flows determine that it is probable an adverse change in cash flows has occurred, then other-than-temporary impairment would be recognized in accordance with FSP FAS 115-2 and FAS 124-2. There is a risk that this quarterly review could result in First Nation Community Bancorp, Inc. recording other-than-temporary impairment charges in the future.

At June 30, 2009, 42% of the total unrealized losses were comprised of fixed income securities issued by U.S. Government agencies, U.S. Government-sponsored enterprises and investment grade municipalities. Corporate fixed income comprised 2% of the total unrealized losses, while pooled trust preferred collateralized debt obligations accounted for 56%.

As of June 30, 2009, the amortized cost of our pooled trust preferred collateralized debt obligations totaled \$34.4 million with an estimated fair value of \$16.5 million. One of our pooled securities is a senior tranch and the remainder are mezzanine tranches. During 2009, all of the pooled issues were downgraded by Moody's Investor Services. At the time of initial issue, no more than 5% of any pooled security consisted of a security issued by any one institution.

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

On a quarterly basis we evaluate our debt securities for other-than-temporary impairment. In the second quarter of 2009, \$242,000 in other-than-temporary impairment charges were recognized on our pooled trust preferred collateralized debt obligations. When evaluating these investments we determine a credit related portion and a noncredit related portion of other-than-temporary impairment. The credit related portion is recognized in earnings and represents the expected shortfall in future cash flows. The noncredit related portion is recognized in other comprehensive income and represents the difference between the fair value of the security and the amount of credit related impairment. A discounted cash flow analysis provides the best estimate of credit related other-than-temporary impairment for these securities.

(7)

Our pooled trust preferred collateralized debt obligations are measured for other-than-temporary impairment within the scope of EITF 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to be Held by a Transferor in Securitized Financial Assets," and FSP EITF 99-20-1, "Amendments to the Impairment Guidance of EITF Issue No. 99-20," by determining whether it is probable that an adverse change in estimated cash flows has occurred. Determining whether there has been an adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of remaining cash flows previously projected against the present value of the cash flows estimated at June 30, 2009. We consider the discounted cash flow analysis to be our primary evidence when determining whether credit related other-than-temporary impairment exists.

(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 June 30, 2009 and December 31, 2008, our FHLB stock totaled $10.9 and $10.4 million, respectively.

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

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

- its operating performance
- the severity and duration of declines in the fair value of its net assets related to its capital stock amount;
- its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;
- 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 June 30, 2009. Our evaluation of the factors described above in future periods could result in the recognition of impairment charges on FHLB stock.

(8)

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;
- our analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

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.

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 June 30, 2009 and 2008. The financial information presented should be read in conjunction with the consolidated financial statements and accompanying notes appearing elsewhere in this report.

Background

The company is a Pennsylvania Corporation, incorporated in 1997 and is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended. The company became an active bank holding company on July 1, 1998 when it assumed ownership of First National Community Bank (the “bank”). On November 2, 2000, the Federal Reserve Bank of Philadelphia approved the company’s application to change its status to a financial holding company as a complement to the company’s strategic objective which includes expansion into financial services activities. The bank is a wholly-owned subsidiary of the company.

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 June 30, 2009, the company had 20 full-service branch banking offices in its principal market area in Lackawanna, Luzerne, Wayne and Monroe Counties, Pennsylvania. At June 30, 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:

(9)

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

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

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

Summary:

Net income for the six months ended June 30, 2009 amounted to $1,022,000, a decrease of $6,678,000 or 87% compared to the same period of the previous year. The decrease is primarily due to an $8.9 million increase in the provision for credit losses caused by deteriorating economic conditions which was partially offset by a $1,225,000 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 $293,000 due to gains on the sale of loans offset by a decrease in gains on security sales of $270,000. Other expenses increased $1,523,000 over the same period of last year due primarily to an increase in Salaries & Benefits of $93,000, an increase in FDIC insurance of $1,071,000 and an increase in other operating expenses of $146,000.

Net loss for the three months ended June 30, 2009 amounted to $2,216,000, a decrease of $5,725,000 compared to the same period of the previous year, as over $7 million was utilized to fund the reserve for credit losses. Net interest income before the provision for credit losses increased $397,000, or 4% over the same period of the previous year. Other income for the quarter increased $77,000, or 5%, while other expenses increased $977,000, or 15% due to an increase in FDIC insurance premiums of $1,097,000..

(10)

RESULTS OF OPERATIONS

Net Interest Income:

The company's primary source of revenue is net interest income which totaled $20,846,000 and $19,621,000 (before the provision for credit losses) during the first six months of 2009 and 2008, respectively. The year to date net interest margin (tax equivalent) increased seventeen basis points to 3.65% in 2009 compared to 2008 comprised of an eighty-one basis point decrease in the yield earned on earning assets which was offset by a one hundred thirteen basis point decrease in the cost of interest-bearing liabilities. Excluding investment leveraging transactions, the 2009 margin would be 3.77% which is twelve basis points higher than the 3.65% recorded during the first six months of last year.

Earning assets increased $2 million to $1.240 billion during the first six months of 2009 and total 93.4% 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:

	Six months ended June 30, 2009		
	Average Balance	Interest	Yield/ Cost
	(Dollars in thousands)		
Assets:			
Interest-earning assets:			
Loans (taxable)	$900,371	$25,220	5.59%
Loans (tax-free) (1)	51,616	1,177	6.98
Investment securities (taxable)	169,440	4,309	5.08
Investment securities (tax-free)(1)	109,608	2,473	6.94
Time deposits with banks and federal funds sold	11,603	13	0.22
Total interest-earning assets	1,242,638	33,192	5.65%
Non-interest earning assets	84,089		