

FIRST NATIONAL COMMUNITY BANCORP INC  
Form 10-K  
March 15, 2007  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-K

ANNUAL REPORT

PURSUANT TO SECTIONS 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 31, 2006  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 333-24121

### **FIRST NATIONAL COMMUNITY BANCORP, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania  
(State or Other Jurisdiction)

23-2900790  
(I.R.S. Employer

of Incorporation or Organization

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

Securities registered pursuant to Section 12(b) of the Act:  
NONE

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Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$1.25 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes \_\_\_\_\_ No

X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or section 15(d) of the Act. Yes \_\_\_\_\_ No X

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

No

The aggregate market value of the voting and non-voting common stock of the registrant, held by non-affiliates was approximately \$368,014,249 at June 30, 2006.

### APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date 12,414,488 shares of common stock as of March 12, 2007.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 16, 2007 are incorporated by reference into Part III of this report.

FIRST NATIONAL COMMUNITY BANCORP, INC.

Part I.

Item 1 Business

CORPORATE PROFILE

The Business of First National Community Bancorp, Inc.

THE COMPANY

First National Community Bancorp, Inc. (the "company") is a Pennsylvania business, 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. The bank is a wholly-owned subsidiary of the company.

The company's primary activity consists of owning and operating the bank, which provides 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.

THE BANK

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 and Luzerne Counties, Pennsylvania:

<u>Office</u>	<u>Date Opened</u>
Main	October 1910
Scranton	September 1980
Dickson City	December 1984
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

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Honesdale

November 2006

The bank provides many commercial banking services to individuals and businesses including Image Checking and E-Statement. Deposit products include standard checking, savings and certificate of deposit products, as well as a variety of preferred products for higher balance customers. The bank also participates in the Certificate of Deposit Registry program which allows customers to secure FDIC insurance on balances in excess of the standard limitations. Consumer loans include both secured and unsecured installment loans, fixed and variable rate mortgages, jumbo mortgages, home equity term loans and lines of credit and "Instant Money" overdraft protection loans. Additionally, the bank is also in the business of underwriting indirect auto loans which are originated through various auto dealers in northeastern Pennsylvania and dealer floor plan loans. VISA personal credit cards are available through the bank, as well as the FNCB Check Card which allows customers to access their checking account at any retail location that accepts VISA and serves the dual purpose of an ATM card. In the commercial lending field, the bank offers demand and term loans, either secured or unsecured, letters of credit, working capital loans, accounts receivable, inventory or equipment financing loans, and commercial mortgages. In addition, the bank offers MasterCard and VISA processing services to its commercial customers, as well as our Cash Management service which can be accessed through FNCBusiness Online,

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which is Internet based. FNCBusiness Online is a menu driven product that allows our business customers to have direct access to their account information and the ability to perform internal and external transfers and process Direct Deposit payroll transactions for employees, 24 hours a day, 7 days a week, from their place of business. As a result of the bank's partnership with INVEST, our customers are able to access alternative products such as mutual funds, annuities, stock and bond purchases, etc. directly from our INVEST representatives. The bank also offers customers the convenience of 24-hour banking, seven days a week, through FNCB Online via the Internet and its ATM network. Automated teller machines are available at the following locations:

### Community Offices

Dunmore  
 Scranton  
 Dickson City  
 Fashion Mall  
 Wilkes-Barre  
 Pittston  
 Kingston  
 Exeter  
 Daleville  
 Plains  
 Back Mountain  
 Clarks Green  
 Hanover Township  
 Nanticoke  
 Hazleton  
 Route 315  
 Honesdale

### Remote Locations

Petro Truck Stop, 98 Grove St., Dupont  
 Bill's Shoprite Supermarket, Rt. 502, Daleville  
 Joe's Kwik Mart, 620 N. Blakely St., Dunmore  
 Joe's Kwik Mart, Rts 940 and I-380, Pocono Summit  
 Joe's Kwik Mart, Route 6, Honesdale  
 Joe's Kwik Mart, Providence Rd. and Main Ave., Scranton  
 Hess Gas Station, 5128 Milford Road, East Stroudsburg

Additionally, to further enhance 24-hour banking services, Telephone Banking (Account Link), Loan by Phone, and Mortgage Link are available to customers. These services provide consumers the ability to access account information, perform related account transfers, and apply for a loan through the use of a touch tone telephone. Also, in our efforts to continually provide consumers the best possible service, the bank implemented in 2004 a Bounce Protection service which provides consumers with an added level of protection against unanticipated cash flow emergencies and account reconciliation errors.

As of December 31, 2006, industry concentrations exist within the following six industries. Loans and lines of credit to each of these industries were as follows:

	Amount	% of Regulatory Capital
Land Subdivision	\$81,258,000	78%
Shopping Centers/Complexes	\$40,285,000	39%
Solid Waste Landfills Industry	\$39,638,000	38%
Hotels	\$37,067,000	35%
Casino Hotels	\$35,000,000	33%
General Government Industry	\$34,826,000	33%

First lien mortgages on the real estate and a diverse group of borrowers, provide security against undue risks in the portfolio.

### COMPETITION

The bank is one of two financial institutions with principal offices in Dunmore. Primary competition in the Lackawanna County market comes from numerous commercial banks and savings and loan associations operating in the area. Our Luzerne County offices share many of the same competitors we face in Lackawanna County as well as several banks and savings and loans that are not in our Lackawanna County market. In

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2006, the bank entered the Wayne County market. Competition for loan and deposit relationships is primarily with three banks headquartered in Wayne County as well as other institutions located within the market. Deposit deregulation has intensified the competition for deposits among banks in recent years. Additional competition is derived from credit unions, finance companies, brokerage firms, insurance companies and retailers.

## SUPERVISION AND REGULATION

The company is subject to the Securities Exchange Act of 1934 ( 1934 Act ) and must file quarterly and annual reports with the U.S. Securities and Exchange Commission regarding its business operations. As a registered financial holding company under the Bank Holding Company Act of 1956, as amended, the company is subject to the supervision and examination by the Federal Reserve Board.

The bank is subject to regulation and supervision by the Office of the Comptroller of the Currency, which includes regular examinations of the bank's records and operations. As a member of the Federal Deposit Insurance Corporation (FDIC), the bank's depositors' accounts are insured up to \$100,000 per ownership category. To obtain this protection for its depositors, the bank pays an assessment and is subject to the regulations of the FDIC. The bank is also a member of the Federal Reserve System and as such is subject to the rules promulgated by the Federal Reserve Board.

Financial Services Modernization Legislation. - In November 1999, the Gramm-Leach-Bliley Act of 1999, or the GLB, was enacted. The GLB repeals provisions of the Glass-Steagall Act which restricted the affiliation of Federal Reserve member banks with firms engaged principally in specified securities activities, and which restricted officer, director or employee interlocks between a member bank and any company or person primarily engaged in specified securities activities.

In addition, the GLB also contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company to engage in a full range of financial activities through a new entity known as a financial holding company. Financial activities is broadly defined to include not only banking, insurance and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may have a subsidiary engaged in any activity authorized for national banks directly or any financial activity, except for insurance underwriting, insurance investments, real estate investment or development, or merchant banking, which may only be conducted through a subsidiary of a financial holding company. Financial activities include all activities permitted under new sections of the Bank Holding Company Act or permitted by regulation.

To the extent that the GLB permits banks, securities firms and insurance companies to affiliate, the financial services industry may experience further consolidation. The GLB is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis and which unitary savings and loan holding companies already possess. Nevertheless, the GLB may have the result of increasing the amount of competition that First National Community Bancorp, Inc. faces from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than First National Community Bancorp, Inc. has.

USA Patriot Act of 2001 - In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington D.C. which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

IMLAFATA - As part of the USA Patriot Act, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (IMLAFATA). IMLAFATA amended the Bank Secrecy Act and adopted certain additional measures that increase the obligation of financial institutions, including First National Community Bancorp, Inc., to identify their customers, watch for and report upon suspicious transactions, respond to requests for information by federal banking regulatory authorities and law enforcement agencies, and share





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information with other financial institutions. The Secretary of the Treasury has adopted several regulations to implement these provisions. First National Community Bancorp, Inc. is also barred from dealing with foreign shell banks. In addition, IMLAFATA expands the circumstances under which funds in a bank account may be forfeited. IMLAFATA also amended the BHC Act and the Bank Merger Act to require the federal banking regulatory authorities to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application to expand operations. First National Community Bancorp, Inc. has in place a Bank Secrecy Act compliance program.

Sarbanes-Oxley Act of 2002 - On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the Act). The stated goals of the Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Act is the most far-reaching U.S. securities legislation enacted in decades. The Act generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (the SEC) under the Securities Exchange Act of 1934. Due to the SEC's extensive role in implementing rules relating to many of the Act's new requirements, the final scope of these requirements remains to be determined.

The Act includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC. The Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The Act addresses, among other matters:

- audit committees for all reporting companies;
- certification of financial statements by the chief executive officer and the chief financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;
- a prohibition on insider trading during pension plan black out periods;
- disclosure of off-balance sheet transactions;
- a prohibition on personal loans to directors and officers; expedited filing requirements for Form 4's;
- disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;
- real time filing of periodic reports;
- the formation of a public accounting oversight board;
- auditor independence; and
- various increased criminal penalties for violations of securities laws.

The Act contains provisions that were effective upon enactment on July 30, 2002 and provisions that will be phased in for up to one year after enactment. The SEC was delegated the task of enacting rules to implement various provisions with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

Regulation W - Transactions between a bank and its affiliates are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to

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insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve Board has also recently issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate. Affiliates of a bank include, among other entities, the bank's holding company and companies that are under common control with the bank. First National Community Bancorp, Inc. is considered to be an affiliate of First National Community Bank. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in covered transactions with affiliates:

- to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and
- to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A covered transaction includes:

- a loan or extension of credit to an affiliate;
- a purchase of, or an investment in, securities issued by an affiliate;
- a purchase of assets from an affiliate, with some exceptions;
- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party;
- and
- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under Regulation W:

- a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;
- covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and
- with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve Board decides to treat these subsidiaries as affiliates.

Concurrently with the adoption of Regulation W, the Federal Reserve Board has proposed a regulation which would further limit the amount of loans that could be purchased by a bank from an affiliate to not more than 100% of the bank's capital and surplus.

### EMPLOYEES

As of December 31, 2006 the bank employed 286 persons, including 59 part-time employees.

### AVAILABLE INFORMATION

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The company files reports, proxy and information statements and other information electronically with the Securities and Exchange Commission. You may read and copy any materials that the company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's website site address is <http://www.sec.gov>. The company's web site address is <http://www.fnbc.com>. The company makes available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we

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electronically file such material with, or furnish it to, the SEC. Further, we will provide electronic or paper copies of the company's filings free of charge upon request. A copy of the company's Annual Report on Form 10-K for the year ended December 31, 2006 may be obtained without charge from our website at [www.fnbc.com](http://www.fnbc.com) or via email at [fnbc@fnbc.com](mailto:fnbc@fnbc.com). Information may also be obtained via written request to First National Community Bancorp, Inc. Attention: Treasurer, 102 East Drinker Street, Dunmore, PA 18512.

### Item 1A. Risk Factors

#### *The Company Is Subject To Interest Rate Risk*

The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies, to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

#### *The Company Is Subject To Lending Risk*

As of December 31, 2006, approximately 50% of the Company's loan portfolio consisted of commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because the Company's loan portfolio contains a significant number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations.

*If the Company's allowance for loan losses is not sufficient to cover actual loan losses, its earnings could decrease.*

The Company's loan customers may not repay their loans according to the terms of their loans, and the collateral securing the payment of their loans may be insufficient to assure repayment. The Company may experience significant credit losses, which could have a material adverse effect on its operating results. The Company makes various assumptions and judgments about the collectability of its loan portfolio, including the creditworthiness of its borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of its loans. In determining the amount of the allowance for loan losses, the Company reviews its loans and its loss and delinquency experience, and the

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Company evaluates economic conditions. If its assumptions prove to be incorrect, its allowance for loan losses may not cover inherent losses in its loan portfolio at the date of its financial statements. Material additions to the Company's allowance would materially decrease its net income. At December 31, 2006, its allowance for loan losses totaled \$7.5 million, representing .90% of its total loans.

Although the Company believes it has underwriting standards to manage normal lending risks, it is difficult to assess the future performance of its loan portfolio due to the relatively recent origination of many of these loans. The Company can give you no assurance that its non-performing loans will not increase or that its non-performing or delinquent loans will not adversely affect its future performance.

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In addition, federal and state regulators periodically review the Company's allowance for loan losses and may require it to increase its allowance for loan losses or recognize further loan charge-offs. Any increase in its allowance for loan losses or loan charge-offs as required by these regulatory agencies could have a material adverse effect on its results of operations and financial condition.

### *The Company's Profitability Depends Significantly On Economic Conditions In The Commonwealth of Pennsylvania specifically in Lackawanna and Luzerne County*

The Company's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the Lackawanna and Luzerne County markets. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Company's financial condition and results of operations.

*There is no assurance that the Company will be able to successfully compete with others for business.*

The Company competes for loans, deposits and investment dollars with numerous regional and national banks and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, and private lenders. Many competitors have substantially greater resources than the Company does, and operate under less stringent regulatory environments. The differences in resources and regulations may make it harder for the Company to compete profitably, reduce the rates that it can earn on loans and investments, increase the rates it must offer on deposits and other funds, and adversely affect its overall financial condition and earnings.

### *The Company's Controls and Procedures May Fail or Be Circumvented*

Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

### *The Company Relies On Dividends From Its Subsidiaries For Most Of Its Revenue*

The Company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company's common stock, interest and principal on debt when applicable, and normal operating expenditures. Various federal and/or state laws and regulations limit the amount of dividends that the Bank and certain non-bank subsidiaries may pay to the Company. Also, its right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to the Company, it may not be able to service debt, pay obligations or pay dividends on the Company's common stock. The inability to receive dividends from the Bank could have a material adverse effect on the Company's business, financial condition and results of operations.

*The Company May Not Be Able To Attract and Retain Skilled People*

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel. The Company does not currently have employment agreements or non-competition agreements with any of its senior officers other than with President and Chief Executive Officer Lombardi.



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### *The Company Is Subject To Claims and Litigation Pertaining To Fiduciary Responsibility*

From time to time, customers make claims and take legal action pertaining to the Company's performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Company's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to the Company they may result in significant financial liability and/or adversely affect the market perception of the Company and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

### *The Trading Volume In The Company's Common Stock Is Less Than That Of Other Larger Financial Services Companies*

The Company's common stock is traded on the Over-the-Counter (OTC) Bulletin Board; the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company's common stock, significant sales of the Company's common stock, or the expectation of these sales, could cause the Company's stock price to fall.

### Item 1B. Unresolved Staff Comments

Not Applicable

### Item 2 - Properties

<u>Property</u>	<u>Location</u>	<u>Ownership</u>	<u>Type of Use</u>
1	102 East Drinker Street Dunmore, PA	Own	Main Office
2	419-421 Spruce Street Scranton, PA	Own	Scranton Branch
3	934 Main Street Dickson City, PA	Own	Dickson City Branch
4	277 Scranton/Carbondale Highway Scranton, PA	Lease	Fashion Mall Branch
5	23 West Market Street Wilkes-Barre, PA	Lease	Wilkes-Barre Branch
6	1700 North Township Blvd. Pittston, PA	Lease	Pittston Plaza Branch
7	754 Wyoming Avenue Kingston, PA	Lease	Kingston Branch
8	1625 Wyoming Avenue		

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	Exeter, PA	Lease	Exeter Branch
9	Route 502 & 435 Daleville, PA	Lease	Daleville Branch
10	27 North River Road Plains, PA	Lease	Plains Branch

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11	169 North Memorial Highway Shavertown, PA	Lease	Back Mountain Branch
12	269 East Grove Street Clarks Green, PA	Own	Clarks Green Branch
13	734 Sans Souci Parkway Hanover Township, PA	Lease	Hanover Township Branch
14	194 South Market Street Nanticoke, PA	Own	Nanticoke Branch
15	330-352 West Broad Street Hazleton, PA	Own	Hazleton Branch
16	3 Old Boston Road Pittston, PA	Lease	Route 315 Branch
17	1001 Main Street Honesdale, PA	Own	Honesdale Branch
18	200 South Blakely Street Dunmore, PA	Lease	Administrative Center
19	107-109 South Blakely Street Dunmore, PA	Own	Parking Lot
20	114-116 South Blakely Street Dunmore, PA	Own	Parking Lot
21	1708 Tripp Avenue Dunmore, PA	Own	Parking Lot
22	Rt. 209 (Milford Road) Marshalls Creek, PA	Own	Land
23	Rt. 940 Blakeslee, PA	Own	Land
24	Corner of Kane & McConnell Sts. Stroudsburg, PA	Own	Land
25	Route 611 Paradise Township, PA	Own	Land

### Item 3 - Legal Proceedings

Neither the company nor its subsidiaries are involved in any material pending legal proceedings, other than routine litigation incidental to the business nor does the company know of any proceedings contemplated by governmental authorities.

### Item 4 - Submission of Matters to a Vote of Security Holders

Not Applicable

Part II.

Item 5 - Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

INVESTOR INFORMATION

MARKET PRICES OF STOCK AND DIVIDENDS PAID

The company's common stock is not actively traded. The principal market area for the company's stock is northeastern Pennsylvania, although shares are held by residents of other states across the country. First National Community Bancorp, Inc. is listed in the Over-The-Counter (OTC) Bulletin Board Stocks under the symbol FNCB. Quarterly market highs and lows and dividends paid for each of the past two years are presented below. These prices represent actual transactions. The company expects that comparable cash dividends will be paid in the future.

<u>QUARTER</u>	<u>MARKET PRICE</u>		<u>DIVIDENDS</u>
	<u>HIGH</u>	<u>LOW</u>	<u>PAID</u>
			<u>PER SHARE</u>
<u>QUARTER</u> 2006			
First	\$27.75	\$23.64	\$ .11
Second	30.20	27.05	.11
Third	29.50	27.90	.12
Fourth	30.00	27.65	.14
			\$ 0.48
<u>QUARTER</u> 2005			
First	\$31.82	\$22.73	\$ .08
Second	28.80	23.41	.08
Third	26.82	23.55	.09
Fourth	25.00	23.45	.12
			\$ 0.37

\* Share and per share information includes the retroactive effect of the 10% stock dividend paid March 31, 2006.

MARKET MAKERS

The following firms are known to make a market in the company's stock:

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Monroe Securities  
47 State Street  
Rochester, NY 14614  
(716) 546-5560

RBC Dain Rauscher  
1211 Avenue of the Americas  
32nd Floor  
New York, NY 10036  
(866) 835-1422

Ryan, Beck and Co.  
220 South Orange Avenue  
Livingston, NJ 07039  
(973) 597-6000

TRANSFER AGENT

Registrar and Transfer Company

10 Commerce Drive

Cranford, NJ 07016-9982

Shareholder questions regarding stock ownership should be directed to the Investor Relations Department at Registrar and Transfer Company at 1-800-368-5948.

#### DIVIDEND CALENDAR

Dividends on the company's common stock, if approved by the Board of Directors, are customarily paid on or about March 15, June 15, September 15 and December 15. Record dates for dividends are customarily on or about March 1, June 1, September 1, and December 1.

General market information may also be obtained from INVEST representatives at (570) 348-4921.

#### EQUITY COMPENSATION PLAN

Information regarding the Company's compensation plans under which equity securities of the registrant are authorized for issuance as of December 31, 2006 is set forth under the caption "Equity Compensation Plan Information" in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated by reference.

#### PERFORMANCE GRAPH

Information regarding the Company's stock performance graph is set forth under the caption "Stock Performance Graph and Table" in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated by reference.

#### PURCHASE OF EQUITY SECURITIES BY THE ISSUER OR AFFILIATED PURCHASERS

None.

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Item 6 Selected Financial Data

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES

SELECTED FINANCIAL DATA

(In thousands, except per share data)

	For the Years Ended December 31,				
	2006	2005	2004	2003	2002
Total assets	\$1,184,783	\$1,008,089	\$907,491	\$816,303	\$735,327
Interest-bearing balances with financial institutions	0	2,178	1,980	2,673	3,368
Securities	270,433	238,223	231,831	211,353	205,492
Net loans	829,121	707,248	625,792	552,197	487,976
Total deposits	920,973	750,666	671,713	602,069	540,475
Long-term debt	147,489	126,942	138,449	133,692	113,883
Stockholders' equity	96,862	84,419	75,723	68,738	62,843
Net interest income before provision for credit losses	35,482	30,950	25,269	23,295	22,060
Provision for credit losses	2,080	1,860	1,400	1,200	1,400
Other income	4,897	3,904	4,789	4,184	3,676
Other expenses	20,773	18,943	17,399	15,483	14,248
Income before income taxes	17,526	14,051	11,259	10,796	10,088
Provision for income taxes	4,017	2,826	1,996	2,159	2,063
Net income	13,509	11,225	9,263	8,637	8,025
Cash dividends paid	\$5,776	\$4,513	\$3,885	\$3,267	\$2,832
Per share data:					
Net income - basic <sup>(1)</sup>	\$1.10	\$0.93	\$0.78	\$0.75	\$0.71
Net income - diluted <sup>(1)</sup>	\$1.07	\$0.90	\$0.75	\$0.71	\$0.68
Cash dividends <sup>(2)</sup>	\$0.48	\$0.37	\$0.33	\$0.28	\$0.25
Book value <sup>(1)(3)</sup>	\$7.89	\$6.98	\$6.39	\$5.93	\$5.55
Weighted average number of shares outstanding - basic <sup>(1)</sup>	12,281,925	12,100,305	10,858,448	11,581,876	11,325,876
Weighted average number of shares outstanding - diluted <sup>(1)</sup>	12,577,193	12,429,988	12,289,846	12,085,909	11,777,539

<sup>(1)</sup> Earnings per share and book value per share are calculated based on the weighted average number of shares outstanding during each year, after giving retroactive effect to the 10% stock dividend paid March 31, 2006 and the 100% stock dividends paid September 30, 2004 and January 31, 2003. Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is computed by dividing net income available to common shareholders, adjusted for any changes in income that would result from the assumed conversion of all potential dilutive common shares, by the sum of the weighted average number of common shares outstanding and the effect of all dilutive potential common shares outstanding for the period.

<sup>(2)</sup> Cash dividends per share have been restated to reflect to retroactive effect of the 10% stock dividend paid March 31, 2006 and the 100% stock dividends paid September 30, 2004 and January 31, 2003.

<sup>(3)</sup> Reflects the effect of SFAS No. 115 in the amount of \$(70,000) in 2006, \$(524,000) in 2005, \$1,030,000 in 2004, \$2,635,000 in 2003 and \$4,838,000 in 2002.



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### Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operation, may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from future results, performance, or achievements expressed or implied by such forward-looking statements. The words expect, anticipate, intend, plan, believe, seek, estimate, and similar expressions are intended to identify such forward-looking statements.

The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation (a) the effects of future economic conditions on the Company and its customers; (b) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; (c) governmental monetary and fiscal policies, as well as legislative and regulatory changes; (d) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters; (e) the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks; (f) the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in the Company's market area and elsewhere, including institutions operating locally, regionally, nationally, and internationally, together with such competitors offering banking products and services by mail, telephone, computer, and the Internet; (g) technological changes; (h) acquisitions and integration of acquired businesses; (i) the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities; and (j) acts of war or terrorism. All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary 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 other documents that are filed periodically with the SEC.

The following financial review of First National Community Bancorp, Inc. is presented on a consolidated basis and is intended to provide a comparison of the financial performance of the company, including its wholly-owned subsidiary, First National Community Bank for the years ended December 31, 2006, 2005 and 2004. The information presented below should be read in conjunction with the company's consolidated financial statements and accompanying notes appearing elsewhere in this report.

#### SUMMARY

Net Income totaled \$13,509,000 in 2006 which was \$2.3 million, or 20%, higher than the \$11,225,000 earned last year. The 2005 earnings were \$1.9 million, or 21%, higher than the \$9,263,000 reported for 2004. Basic earnings per share increased 18% in 2006 from the \$0.93 per share reported in 2005 to \$1.10. In 2005, basic earnings per share improved 19% from \$0.78 in 2004 to \$0.93. The weighted average number of shares outstanding used to calculate basic earnings per share was 12,281,925 in 2006, 12,100,305 in 2005 and 11,858,448 in 2004.

Total interest income improved \$15.3 million in 2006, while total interest expense increased \$10.8 million, resulting in a \$4.5 million increase in net interest income before the provision for credit losses. Balance sheet growth and the positive impact of repricing on interest-sensitive assets and liabilities contributed to the improvement over the prior year. Income generated from service charges on deposits and other sources of fee income increased \$634,000 compared to the 2005 total, and gains from the sale of assets were \$359,000 higher than the previous year, resulting in a \$1.0 million increase in other income. Operating expenses increased \$1.8 million, or 10%, in 2006 and the company increased the provision for credit losses by \$220,000 to cover losses. Federal income tax expense increased \$1.2 million due to the improvement in pre-tax income.

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The improvement in earnings recorded in 2005 was due primarily to the \$5.7 million increase in net interest income before providing for credit losses, as balance sheet growth and interest rate increases had a positive impact on earnings. Income from service charges and fees also increased \$511,000 over the 2004 level, but a \$1.4 million decrease in gains on asset sales, a \$1.5 million increase in operating expenses and a \$460,000 increase in the provision for credit losses offset a portion of the 22% increase in operating income. Federal income tax expense increased \$830,000 due to the increased earnings.

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The company's return on assets for the years ended December 31, 2006, 2005 and 2004 was 1.26%, 1.18% and 1.08%, respectively while the return on average equity was 15.30%, 13.96% and 12.86%.

### NET INTEREST INCOME

Net interest income, the difference between interest income and fees on earning assets and interest expense on deposits and borrowed funds, is the largest component of the company's operating income and as such is the primary determinant of profitability. Changes in net interest income occur due to fluctuations in the balances and/or mixes of interest-earning assets and interest-bearing liabilities, and changes in their corresponding interest yields and costs. Before providing for future credit losses, net interest income increased \$4,532,000 in 2006 due to growth in loans and deposits and the positive effect of the spread earned on interest sensitive assets and liabilities. Changes in non-performing assets, together with interest lost and recovered on those assets, also impact comparisons of net interest income. In the following schedules, net interest income is analyzed on a tax-equivalent basis, thereby increasing interest income on certain tax-exempt loans and investments by the amount of federal income tax savings realized. In this manner, the true economic impact on earnings from various assets and liabilities can be more accurately compared.

In 2006, tax-equivalent net interest income improved \$4.8 million, or 15%, when compared to the prior year. Growth of the balance sheet, effective asset-liability management strategies and the positive impact due to re-pricing all contributed to earnings improvement.

Average loans outstanding increased \$101 million, or 15%, in 2006. The average yield earned on the loan portfolio improved ninety-eight basis points, resulting in a \$14.2 million increase in income earned on total loans. Commercial loans provided the majority of the increase as balances grew \$79 million, or 15%, and earnings improved \$12.3 million, or 34%. The significant growth in earnings can be attributed to the volume of variable rate loans in the portfolio which benefited from rising interest rates in 2006. Retail loans outstanding increased \$22 million in 2006, which represents a 16% increase. Earnings on retail loans improved \$1.9 million, or 24%. The majority of the increase was generated from installment loans, including indirect auto loans, while income from residential mortgage loans and home equity lending also improved.

Average securities increased \$15 million in 2006 as excess funds generated from the acquisition of a community office were utilized in the investment portfolio. The increased balances combined with a thirty-nine basis point improvement in the yield earned provided an additional \$1.7 million of interest income over the prior year. Money market balances decreased \$7.6 million on average as funds were utilized in higher earning assets. Earnings on this category of assets decreased \$233,000 in 2006 due to the reduced balances.

Average interest-bearing deposit balances increased \$92 million, or 14%, in 2006. Interest-bearing demand deposits grew \$34 million during the year due to activity in large commercial accounts and municipal relationships as well as deposits purchased while average savings deposits decreased \$9 million. Average time deposits increased \$67 million, or 20%, as many customers invested funds as interest rates paid on certificates of deposit increased. The average cost of interest-bearing deposits increased 1.07% over the 2005 rate. Average borrowed funds outstanding increased \$7 million in 2006, and the average rate paid on these borrowings was twenty-five basis points higher than the rate paid in 2005.

Overall, growth of the balance sheet offset a one basis point decrease in the spread earned, resulting in the \$4.8 million increase in tax-equivalent net interest income. The net interest margin improved nine basis points to 3.73% during the year due to the changing mix of the balance sheet and the positive impact of repricing. Investment leveraging transactions continued to add to the predictability of the company in 2006, contributing almost \$700,000 to pre-tax earnings, but the average spread earned on the transactions was 1.15% which negatively impacted the net interest margin. Exclusive of these transactions, the company's 2006 net interest margin would have been 3.88% which is six basis points higher than the 3.82% recorded last year.

During 2005, tax-equivalent net interest income increased \$5,890,000, or 22%, over the 2004 level. Significant loan growth combined with a 2.00% increase in the prime lending rate had a major impact on the improved earnings. Effective asset-liability management techniques also contributed to the earnings improvement as sound pricing policies enabled the company to increase the net interest margin from the 3.34% recorded in 2004 to 3.64%.

Average loans increased \$71 million, or 12%, over the 2004 level and the average yield earned on total loans improved .88% in 2005, resulting in a \$9.8 million increase in earnings from the portfolio. Commercial lending provided the majority of the growth, adding over \$64 million of balances on average and \$9.4 million of the earnings

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improvement. Average consumer loans outstanding increased \$6.9 million in 2005 due primarily to growth in indirect auto loans and home equity lending.

Average investment securities were \$18 million higher than the prior year, and the higher yields recorded on new purchases contributed to a .13% increase in the average yield earned, resulting in \$1.2 million of additional interest income. Money market assets also benefited from Federal Reserve interest rate increases, as \$255,000 of additional earnings were derived from a \$4 million increase in average balances.

Deposit growth was significant in 2005, due primarily to increased municipal relationships and positive fluctuations in existing commercial accounts. Average interest-bearing deposit balances grew \$84.5 million in 2005. Municipal growth contributed to a \$56.5 million increase in interest-bearing demand balances and also factored into the .61% increase in the cost of these funds. Time deposits greater than \$100,000 increased \$27 million on average as commercial customers took advantage of rising interest rates and moved monies into these higher earning deposits. Overall, the company's cost of deposits increased .53% in 2005, resulting in a \$5 million increase in interest expense. Borrowed funds and other interest-bearing liabilities increased \$4 million on average, and this growth combined with a .15% increase in the cost of these borrowings added \$422,000 of interest expense in 2005.

As a result, the positive growth of the balance sheet combined with effective pricing strategies led to improvement in the net interest margin from the 3.34% reported in 2004 to 3.64% in 2005. Another factor affecting the company's net interest margin was investment leveraging transactions which match assets with liabilities at various points in the interest rate cycles. These transactions provided over \$700,000 of net interest income in 2005, but the interest spread of 1.22% had a negative impact on the company's net interest margin. Exclusive of these transactions, the 2005 margin would have been 3.82% which is .26% higher than the comparable 3.56% recorded in 2004.

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Yield Analysis

(dollars in thousands-taxable equivalent basis)(1)

	2006			2005			2004		
	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate
<b>ASSETS:</b>									
<b>Earning Assets:(2)</b>									
Commercial loans-taxable	\$576,002	\$45,461	7.89%	\$498,014	\$33,343	6.70%	\$435,758	\$24,076	5.53%
Commercial loans-tax free	31,085	2,256	7.26%	30,208	2,141	7.09%	28,348	2,004	7.07%
Mortgage loans	29,642	1,961	6.62%	22,576	1,483	6.57%	21,863	1,372	6.28%
Installment loans	131,767	7,994	6.07%	116,767	6,538	5.60%	110,560	6,212	5.62%
Total Loans	768,496	57,672	7.50%	667,565	43,505	6.52%	596,529	33,664	5.64%
Securities-taxable	177,315	8,338	4.70%	173,529	7,330	4.22%	163,782	6,617	4.04%
Securities-tax free	69,313	4,996	7.21%	58,119	4,302	7.40%	49,586	3,824	7.71%
Total Securities	246,628	13,334	5.41%	231,648	11,632	5.02%	213,368	10,441	4.89%
Interest-bearing deposits with banks	1,279	55	4.30%	2,059	70	3.40%	2,063	44	2.13%
Federal funds sold	1,406	73	5.19%	8,246	291	3.53%	4,121	62	1.50%
Total Money Market Assets	2,685	128	4.77%	10,305	361	3.50%	6,184	106	1.70%
Total Earning Assets	1,017,809	71,134	6.99%	909,518	55,498	6.10%	816,081	44,211	5.42%
Non-earning assets	59,947			52,003			49,980		
Allowance for credit losses	(7,873)			(7,748)			(6,848)		
Total Assets	\$1,069,883			\$953,773			\$859,213		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>									
<b>Interest-Bearing Liabilities:</b>									
Interest-bearing demand deposits	\$254,065	\$6,453	2.54%	\$220,373	\$3,499	1.59%	\$163,826	\$1,605	0.98%
Savings deposits	72,889	960	1.32%	81,899	868	1.06%	80,112	599	0.75%
Time deposits over \$100,000	162,559	7,143	4.39%	126,855	3,863	3.05%	99,584	2,102	2.11%
Other time deposits	246,993	10,959	4.44%	215,338	7,176	3.33%	216,453	6,125	2.83%
Total Interest-Bearing Deposits	736,506	25,515	3.46%	644,465	15,406	2.39%	559,975	10,431	1.86%
Borrowed funds and other									
Interest-bearing liabilities	159,714	7,671	4.80%	152,748	6,951	4.55%	148,309	6,529	4.40%
Total Interest-Bearing Liabilities	896,220	33,186	3.70%	797,213	22,357	2.80%	708,284	16,960	2.39%
Demand deposits	73,637			68,572			72,700		
Other liabilities	11,746			7,574			6,224		
Stockholders' equity	88,280			80,414			72,005		
Total Liabilities and Stockholders' Equity	\$1,069,883			\$953,773			\$859,213		
Net Interest Income Spread		\$37,948	3.29%		\$33,141	3.30%		\$27,251	3.03%
Net Interest Margin			3.73%			3.64%			3.34%

(1) In this schedule and other schedules presented on a tax-equivalent basis, income that is exempt from federal income taxes, i.e. interest on state and municipal securities, has been adjusted to a tax-equivalent basis using a 34% federal income tax rate.

(2) Excludes non-performing loans.

## RATE VOLUME ANALYSIS

The most significant impact on net income between periods is derived from the interaction of changes in the volume and rates earned or paid on interest-earning assets and interest-bearing liabilities. The volume of earning dollars in loans and investments, compared to the volume of interest-bearing liabilities represented by deposits and borrowings, combined with the spread, produces the changes in net interest income between periods. Components of interest income and interest expense are presented on a tax-equivalent basis using the statutory federal income tax rate of 34%.

The following table shows the effect of changes in volume and interest rates on net interest income. The variance in interest income or expense due to the combination of rate and volume has been allocated proportionately.

Rate/Volume Variance Report(1)  
(in thousands-taxable equivalent basis)

	2006 vs 2005			2005 vs 2004		
	Total Change	Increase(Decrease)		Total Change	Increase(Decrease)	
		Due to Volume	Due to Rate		Due to Volume	Due to Rate
<b>Interest Income:</b>						
Commercial loans-taxable	\$ 12,118	\$ 5,252	\$ 6,866	\$ 9,267	\$ 3,552	\$ 5,715
Commercial loans-tax free	115	63	52	137	132	5
Mortgage loans	478	464	14	111	45	66
Installment loans	1,456	889	567	326	362	(36)
Total Loans	14,167	6,668	7,499	9,841	4,091	5,750
Securities-taxable	1,008	176	832	713	394	319
Securities-tax free	694	829	(135)	478	658	(180)
Total Securities	1,702	1,005	697	1,191	1,052	139
Interest-bearing deposits with banks	(15)	(27)	12	26	0	26
Federal funds sold	(218)	(241)	23	229	62	167
Total Money Market Assets	(233)	(268)	35	255	62	193
Total Interest Income	15,636	7,405	8,231	11,287	5,205	6,082
<b>Interest Expense:</b>						
Interest-bearing demand deposits	2,954	459	2,495	1,894	648	1,246
Savings deposits	92	(96)	188	269	14	255
Time deposits over \$100,000	3,280	1,087	2,193	1,761	579	1,182
Other time deposits	3,783	1,256	2,527	1,051	(25)	1,076
Total Interest-Bearing Deposits	10,109	2,706	7,403	4,975	1,216	3,759
Borrowed funds and other interest-bearing liabilities	720	223	497	422	195	227
Total Interest Expense	10,829	2,929	7,900	5,397	1,411	3,986
Net Interest Income	\$ 4,807	\$ 4,476	\$ 331	\$ 5,890	\$ 3,794	\$ 2,096

(1) Changes in interest income and interest expense attributable to changes in both volume and rate have been allocated proportionately to changes due to volume and changes due to rate.





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### CURRENT YEAR

During 2006, tax-equivalent net interest income increased \$4.8 million over the prior year total. Balance sheet growth was profitable as evidenced by the \$4.5 million of improvement related to volume. The repricing of interest sensitive assets and liabilities combined with growth at current market levels contributed to a positive variance due to rate for a second consecutive year.

Interest income recognized on loans increased \$14.2 million in 2006. The \$101 million increase in average loans outstanding led to a \$6.7 million increase in interest income, while repricing resulting from Federal Reserve interest rate increases combined with growth at higher rates contributed to the \$7.5 million improvement due to rate. Investment securities added \$1.7 million more interest income in 2006 due to the \$15.0 million increase in average balances and the repositioning of the taxable securities portfolio into higher earning assets. Earnings from money market assets were \$233,000 less than the prior year as funds were utilized in higher earning asset categories.

New deposits added \$2.7 million of interest expense in 2006, but rising interest rates led to an additional \$7.4 million of interest expense. The \$10.1 million of additional cost on deposits combined with a \$700,000 increase in the cost of borrowings resulted in a \$10.8 million rise in interest expense.

### PRIOR YEAR

In 2005, tax-equivalent net interest income was \$5.9 million higher than the 2004 total. Growth of the balance sheet added \$3.8 million to earnings in 2005 as the \$5.2 million of income earned on new loans and securities more than offset the \$1.4 million cost of new deposits and borrowings. Loan growth added \$4.1 million of income while new securities and money market assets provided an additional \$1.1 million. Interest expense increased \$1.2 million due to deposit growth while additional borrowings cost \$200,000. Interest rate increases and repricing to current levels also had a positive impact on earnings in 2005. The increased yield on loans resulted in a \$5.7 million increase due to rate while income from investment securities and money market assets increased \$330,000 from the 2004 level. Interest expense was also impacted by rising rates but to a lesser extent, resulting in a \$4.0 million increase in interest expense. Interest on deposits increased \$3.8 million in 2005 while the cost of borrowed funds increased \$227,000.

### 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 conditions. Consideration is also given to examinations performed by regulatory authorities and the company's independent auditors. The provision for credit losses was \$2,080,000 in 2006, \$1,860,000 in 2005, and \$1,400,000 in 2004. The ratio of the loan loss reserve to total loans was .90% at December 31, 2006 and 1.05% at December 31, 2005.

### OTHER INCOME

<u>Other Income</u>	2006	2005	2004
	(in thousands)		
Service charges	\$2,645	\$2,240	\$1,929

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Net gain/(loss) on the sale of securities	(201)	(250)	846
Net gain on the sale of loans	240	210	499
Net gain on the sale of other real estate	297	14	25
Net loss on the sale of other assets	(3)	0	0
Other	1,919	1,690	1,490
Total Other Income	\$4,897	\$3,904	\$4,789

The company's other income category can be separated into three distinct sub-categories; service charges make up the core component of this area of earnings while net gains (losses) from the sale of assets and other fee income comprise the balance.

During 2006, total other income increased \$1.0 million, or 25%, over the 2005 total due to improvement in all three components. Service charges improved \$405,000, or 18%, due primarily to a \$364,000 increase in overdraft privilege fees. Income generated from the sale of assets increased \$359,000 compared to 2005. Securities were sold to

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reposition the portfolio for future benefits and residential mortgages were sold to reduce the company's exposure to interest rate risk. Additionally, a \$297,000 gain was recognized from the sale of several properties which were previously classified as Other Real Estate Owned. Other fee income also increased \$229,000, or 13%, due to a \$229,000 increase in fees recognized on outstanding letters of credit.

In 2005, other income decreased \$885,000 compared to the prior year due to a \$1.4 million negative variance in income generated from the sale of assets. Income from securities sales decreased \$1.1 million to a \$250,000 net loss in 2005 as rising interest rates led to portfolio restructuring which was projected to have a positive impact on future periods. Residential mortgage loan sales to shed long-term interest rate risk continued in 2005, but rising interest rates also contributed to a \$289,000 decrease from the prior year in this area. Service charge income improved \$311,000, or 16%, in 2005 due to increased overdraft privilege fees and income from automated teller machines. All other income improved \$200,000 in 2005 due primarily to earnings from our relationship with INVEST Financial Corp. and check card processing.

### OTHER EXPENSES

Other Expenses	2006	2005	2004
	(in thousands)		
Salary expense	\$ 8,494	\$ 7,775	\$ 6,905
Employee benefit expense	2,090	1,877	1,787
Occupancy expense	1,626	1,676	1,556
Equipment expense	1,388	1,293	1,257
Directors fees	600	528	468
Advertising expense	705	706	650
Data processing expense	1,560	1,435	1,309
Bank shares tax	563	473	583
Other operating expenses	3,747	3,180	2,884
Total Other Expenses	\$20,773	\$18,943	\$17,399

In 2006, total other expenses increased \$1.8 million, or 10%, from the prior year total. Employee costs rose \$932,000, which accounts for 50% of the increase, while data processing and shares tax expense increased approximately \$100,000 each. All other expenses increased \$683,000, or 9%. The company's overhead ratio, which measures non-interest expense as a percentage of average assets, was 1.94% in 2006 compared to 1.99% in 2005, reflecting the stringent controls over expenses in spite of the significant growth recorded during the year.

Salary and benefit costs accounted for 51% of total operating expenses in 2006. The \$932,000 increase in employee costs includes a \$719,000 increase in salaries and a \$213,000 increase in employee benefits as new employees were added to support growth. The addition of the new community office in Honesdale and higher contributions to the Employee's Profit Sharing Plan and deferred compensation plans also contributed to the increase. As of December 31, 2006, the company had 257 full-time equivalent employees on staff, an 8% increase over the 238 reported on December 31, 2005.

Occupancy and equipment costs rose a mere \$45,000 in 2006. The increase in all other operating expenses includes a \$135,000 increase in legal fees related to loan work-outs and branch expansion.

During 2005, total other expenses increased \$1.5 million, or 9%, from the 2004 level. Employee costs increased \$960,000, or 62% of the total while occupancy and equipment costs rose \$156,000. All other expenses increased \$428,000, or 28% of the total increase. The company's overhead ratio was 1.99% in 2005 compared to 2.02% in 2004.

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Salaries increased \$870,000 in 2005 including a \$492,000 increase in regular salaries and a \$287,000 increase in expenses due to FAS 91 salary deferrals. The increase in regular salaries was due to merit increases and staff additions while the additional FAS 91 expense reflects a decrease in the number of loan closings recorded during the year and the deferred costs associated with the loan closings. Stock based compensation and incentive compensation also added \$91,000 to the salary expense variance in 2005. Employee benefit costs increased \$90,000 over the 2004 level due to the company's increased contribution to the Employees Profit Sharing Plan and payroll taxes associated with the increased level of salaries. At December 31, 2005, the company had 238 full-time equivalent employees on staff compared to the 236 reported on December 31, 2004.

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Occupancy and equipment costs increased 8% and 3%, respectively, due primarily to increased maintenance expenses. All other operating expenses increased \$428,000, or 7%. Much of the increase was attributed to rising data processing costs and the increased cost of goods and services.

### PROVISION FOR INCOME TAXES

Federal income tax expense increased \$1.2 million in 2006 due primarily to the \$3.5 million improvement in income before taxes. Benefits derived from tax-exempt income and other permanent differences had a positive impact in 2006. The company's effective tax rate was 22.9% in 2006 and 20.1% in 2005.

In 2005, federal income tax expense increased \$830,000 compared to 2004. The \$2.8 million increase in income before taxes added \$949,000 to the book provision while benefits received from tax-exempt income and other permanent differences had a \$119,000 positive effect compared to 2004. The company's effective tax rate was 20.1% in 2005 and 17.7% in 2004.

### FINANCIAL CONDITION

Total assets increased \$177 million, or 18%, during 2006 due to significant internal growth and the acquisition of a community office. Internal asset growth amounted to \$102 million, or 10%, while assets acquired totaled \$75 million. Loan growth of \$122 million and a \$32 million increase in securities was funded by a \$170 million increase in total deposits.

### SECURITIES

The primary objectives in managing the company's securities portfolio are to maintain the necessary flexibility to meet liquidity and asset and liability management needs and to provide a stable source of interest income.

Total securities increased \$32 million in 2006 as excess funds received from the acquisition of a branch office were utilized to fund securities purchases. During the year, an emphasis was placed on adding securities which would reduce the company's risk to declining interest rates. Additionally, due to the significant growth recorded in municipal deposit relationships, an emphasis was placed on adding securities which would provide eligible collateral for those deposits. Municipal bonds and eligible U.S. Agency securities were added to meet collateral needs, while holdings of mortgage-backed securities were reduced through principal prepayments and sales.

During 2006, the company did not add any investment leveraging transactions due to limited borrowing capacity at the Federal Home Loan Bank. As of December 31, 2006, the company had \$65 million of these leveraged transactions outstanding. Management remains committed to strategies which limit purchases to those that are virtually free of credit risk and will help to meet the objectives of the company's investment and asset/liability management policies. Investment sales were executed to shed the portfolio of low earning bonds and bonds which had been reduced in size by principal prepayments to below portfolio parameters.

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The following table sets forth the carrying value of securities at the dates indicated:

	<u>December 31,</u> 2006 (in thousands)	2005	2004
U.S. Treasury securities and obligations of U.S. government agencies	\$59,347	\$48,175	\$ 31,770
Obligations of state and political subdivisions	77,128	65,226	55,955
Collateralized mortgage obligations	63,288	47,368	56,345
Mortgage-backed securities	42,501	48,682	60,705
Corporate debt securities	20,006	20,008	18,983
Equity securities	8,163	8,764	8,073
Total	\$270,433	\$238,223	\$231,831

The following table sets forth the maturities of securities at December 31, 2006 (in thousands) and the weighted average yields of such securities calculated on the basis of the cost and effective yields weighted for the scheduled

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maturity of each security. Tax-equivalent adjustments, using a 34% rate, have been made in calculating yields on obligations of state and political subdivisions.

	Mortgage-						<u>Total</u>
	Within	2 - 5	6 - 10	Over	Backed	No Fixed	
	<u>One Year</u>	<u>Years</u>	<u>Years</u>	<u>10 Years</u>	<u>Securities</u>	<u>Maturity</u>	
U.S. Treasury securities	\$ 499	\$ 503	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,002
Yield	4.23%	4.39%					4.31%
Obligations of U.S. government agencies							
Yield		9,959	31,607	16,934			58,500
Obligations of state and political subdivisions (1)		4.00%	5.23%	5.29%			5.04%
Yield			9,438	65,987			75,425
Corporate debt securities			6.74%	6.84%			6.83%
Yield		979	1,589	17,510			20,078
Collateralized mortgage obligations		4.50%	4.83%	6.29%			6.09%
Yield					64,041		64,041
Mortgage-backed securities					4.98%		4.98%
Yield					43,315		43,315
Equity securities (2)					4.89%		4.89%
Yield						8,178	8,178
Total maturities	\$ 499	\$11,441	\$42,634	\$100,431	\$107,356	\$8,178	\$270,539
Weighted yield	4.23%	4.06%	5.55%	6.48%	4.94%	4.95%	5.57%

(1) Yields on state and municipal securities have been adjusted to a tax-equivalent basis using a 34% federal income tax rate.

(2) Yield presented represents 2006 actual return.

## LOANS

Total loans increased \$122 million, or 17% in 2006 including \$21 million acquired with a branch purchase. Real estate loans again contributed significantly to the growth, as evidenced by the \$88 million increase in this segment of the portfolio. Commercial mortgages provided \$49 million of the growth in 2006 while residential mortgage balances increased \$10 million, home equity lending added \$6 million and other real estate secured loans increased \$23 million. The growth in residential mortgage loans was recorded after accounting for the sale of over \$15 million of loan balances in 2006 to reduce the company's exposure to interest rate risk and to secure funding for additional loan originations. Installment loans outstanding increased \$7.6 million due to growth in the company's indirect lending portfolio. Other commercial loan balances increased \$25 million during the year.

Details regarding the loan portfolio for each of the last five years ending December 31 are as follows:

Loans Outstanding (in thousands)

	2006	2005	2004	2003	2002
Commercial and Financial	\$157,837	\$132,838	\$130,937	\$132,319	\$115,651
Real Estate	567,030	478,582	402,792	337,423	294,864
Installment	80,770	73,217	69,027	66,981	63,258
Other	31,591	30,139	30,136	22,052	20,343
Total Loans Gross	837,228	714,776	632,892	558,775	494,116
Unearned Discount	(569)	0	0	0	0
Allowance for Credit Losses	(7,538)	(7,528)	(7,100)	(6,578)	(6,140)
Net Loans	\$829,121	\$707,248	\$625,792	\$552,197	\$487,976



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The following schedule shows the repricing distribution of loans outstanding as of December 31, 2006. Also provided are these amounts classified according to sensitivity to changes in interest rates.

### Loans Outstanding - Repricing Distribution (in thousands)

	Within	One to	Over Five	Total
	One Year	Five Years	Years	
Commercial and Financial	\$113,224	\$39,751	\$4,862	\$157,837
Real Estate	355,479	129,890	81,661	567,030
Installment	2,623	70,884	7,263	80,770
Other	8,989	5,727	16,875	31,591
<b>Total</b>	<b>\$480,315</b>	<b>\$246,252</b>	<b>\$110,661</b>	<b>\$837,228</b>
Loans with predetermined interest rates	\$117,316	\$113,039	\$92,335	\$322,690
Loans with floating rates	362,999	133,213	18,326	514,538
<b>Total</b>	<b>\$480,315</b>	<b>\$246,252</b>	<b>\$110,661</b>	<b>\$837,228</b>

### ASSET QUALITY

The company manages credit risk through the application of policies and procedures designed to foster sound underwriting and credit monitoring practices, although, as is the case with any financial institution, a certain degree of credit risk is dependent in part on local and general economic conditions that are beyond the company's control.

The company's risk management committee meets quarterly or more often as required and makes recommendations to the board of directors regarding provisions for credit losses. The committee reviews individual problem credits and ensures that ample reserves are established considering both general allowances and specific allocations.

The following schedule reflects various non-performing categories as of December 31 for each of the last five years:

	2006	2005	2004	2003	2002
	(in thousands)				
Nonaccrual:					
Impaired	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other	2,299	70	303	844	37
Loans past due 90 days or more and still accruing	412	721	539	622	299
Other Real Estate Owned	2,188	0	0	0	0
<b>Total Non-Performing Assets</b>	<b>\$4,899</b>	<b>\$791</b>	<b>\$842</b>	<b>\$1,466</b>	<b>\$336</b>

In 2006, total non-performing assets increased \$4.1 million. Nonaccrual loans increased \$2.2 million due to the addition of three credits caused by the borrowers' inability to make scheduled payments. As of December 31, 2006, the company has recognized a loss of \$902,000 on these credits. Any future losses from loans carried as nonaccrual is expected to be minimal after accounting for the sale of the collateral. Other Real Estate Owned increased \$2.1 million in 2006 due to the addition of one property obtained in lieu of foreclosure. Title to this property is subject

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to a future lease option payment payable in 2008. As of December 31, 2006, the company has recognized a loss of \$953,000 on this credit. Any future loss is expected to be minimal based on the market value of the property and the carrying value of the asset. No losses were recognized in 2006 on loans carried as nonaccrual on December 31, 2005.

During 2005, total non-performing assets decreased \$51,000. Nonaccrual loans decreased \$233,000 during the year and are now limited to \$70,000. Scheduled payments combined with a \$186,000 charge-off of loans classified as nonaccrual on December 31, 2004 account for the reduction. Any future loss resulting from loans classified as nonaccrual on December 31, 2005 would be minimal. Loans past due over ninety days increased \$182,000 during the year. The carrying balance of other real estate owned on December 31, 2005 was \$0.

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On December 31, 2006, the company's ratio of nonaccrual loans to total loans was .27% compared to the .01% reported in 2005. The ratio of the allowance for credit losses was .90% at December 31, 2006 compared to 1.05% in 2005, reflecting growth in loans, asset quality and regulatory guidance pertaining to the allowance. We continue to rank well ahead of peer banks in measurements of delinquency. The company continues to acknowledge the weakness in local real estate markets, emphasizing strict underwriting standards to minimize the negative impact of the current environment.

### ALLOWANCE FOR CREDIT LOSSES

The following table presents an allocation of the allowance for credit losses as of the end of each of the last five years (in thousands):

#### Loan Loss Reserve Allocation (in thousands)

	12/31/06		12/31/05		12/31/04		12/31/03		12/31/02	
	Amount	Percentage of Loans in Each Category to Total Loans	Amount	Percentage of Loans in Each Category to Total Loans	Amount	Percentage of Loans in Each Category to Total Loans	Amount	Percentage of Loans in Each Category to Total Loans	Amount	Percentage of Loans in Each Category to Total Loans
Commercial and Financial	\$6,995	77%	\$6,933	79%	\$4,028	79%	\$5,303	76%	\$4,840	76%
Real Estate	114	4%	55	4%	44	3%	53	4%	44	5%
Installment	377	19%	427	17%	292	18%	276	20%	244	19%
Unallocated	52	-	113	-	2,736	-	946	-	1,012	-
	\$7,538	100%	\$7,528	100%	\$7,100	100%	\$6,578	100%	\$6,140	100%

The following schedule presents an analysis of the allowance for credit losses for each of the last five years (in thousands):

	Year Ended December 31,				
	2006	2005	2004	2003	2002
Balance, January 1	\$7,528	\$7,100	\$6,578	\$6,140	\$5,594
Charge-Offs:					
Commercial and Financial	83	64	293	314	256
Real Estate	1,802	1,523	412	109	455
Installment	535	435	423	579	307
Total Charge-Offs	2,420	2,022	1,128	1,002	1,018
Recoveries on Charged-Off Loans:					
Commercial and Financial	8	257	51	13	2
Real Estate	110	108	66	7	10
Installment	232	225	133	220	152

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Total Recoveries	350	590	250	240	164
Net Charge-Offs	2,070	1,432	878	762	854
Provision for Credit Losses	2,080	1,860	1,400	1,200	1,400
Balance, December 31	\$7,538	\$7,528	\$7,100	\$6,578	\$6,140

Net Charge-Offs during the period  
as a percentage of average loans  
outstanding during the period

	.27%	.21%	.15%	.15%	.18%
--	------	------	------	------	------

Allowance for credit losses as a  
percentage of net loans outstanding  
at end of period

	.90%	1.05%	1.12%	1.18%	1.24%
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Net charge-offs total \$2.1 million in 2006 due primarily to deterioration in two relationships. Based on management's evaluation of the borrowers ability to make future payments and the value of the underlying collateral, charge-offs totaling \$1.6 million were recommended and processed in the fourth quarter. As a result of these charge-offs, the company determined that additional provisions were necessary to maintain the strength of the reserve and provided an additional \$1,000,000 in December. Other activity is consistent with prior periods and includes writedowns on credits incurred in the normal course of business. The installment loan charge-offs include \$305,000 of indirect auto loans, of which \$220,000 was recovered in 2006 through sales of the vehicles. During 2006, there were no charge-offs on loans carried as nonaccrual on December 31, 2005. The company's ratio of net charge-offs to average loans is comparable to its national peer groups while the ratio of the allowance for credit losses to total loans is adequate considering current delinquency levels.

### DEPOSITS

The primary source of funds to support the company's growth is its deposit base, and emphasis has been placed on accumulating new deposits while making every effort to retain current relationships. Total deposits increased \$170 million in 2006 comprised of \$49 million in lower costing savings and demand accounts and a \$121 million increase in time deposit balances. Included in the 2006 growth is \$74 million of deposits acquired through the purchase of a branch office.

The average daily amount of deposits and rates paid on such deposits is summarized for the periods indicated in the following table (in thousands):

	Year Ended December 31,		2005		2004	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand deposits	\$73,637		\$68,572		\$72,700	
Interest-bearing demand deposits	254,065	2.54%	220,373	1.59%	163,826	0.98%
Savings deposits	72,889	1.32%	81,899	1.06%	80,112	0.75%
Time deposits	409,552	4.42%	342,193	3.23%	316,037	2.60%
Total	\$810,143		\$713,037		\$632,675	

Maturities of time deposits of \$100,000 or more outstanding at December 31, 2006, are summarized as follows (in thousands):

3 months or less	\$104,565
Over 3 through 6 months	17,154
Over 6 through 12 months	37,689
Over 12 months	28,476
Total	\$187,884

### CAPITAL

A strong capital base is essential to the continued growth and profitability of the company and is therefore 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 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.



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The following schedules present information regarding the company's risk-based capital at December 31, 2006, 2005 and 2004 and selected other capital ratios.

### CAPITAL ANALYSIS

(in thousands)

	December 31,		
	2006	2005	2004
Tier I Capital:			
Total Tier I Capital	\$ 97,048	\$ 84,943	\$ 74,693
Tier II Capital:			
Allowable portion of allowance for credit losses	\$ 7,538	\$ 7,528	\$ 7,100
Total Risk-Based Capital	\$104,586	\$ 92,471	\$ 81,793
Total Risk-Weighted Assets	\$980,201	\$819,339	\$728,681

### CAPITAL RATIOS

	Regulatory			
	<u>Minimum</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total Risk-Based Capital	8.00%	10.67%	11.29%	11.22%
Tier I Risk-Based Capital	4.00%	9.90%	10.37%	10.25%
Tier I Leverage Ratio	4.00%	9.16%	8.91%	8.69%
Return on Assets	N/A	1.26%	1.18%	1.08%
Return on Equity*	N/A	15.30%	13.96%	12.86%
Equity to Assets Ratio*	N/A	8.18%	8.37%	8.34%
Dividend Payout Ratio	N/A	42.75%	40.20%	41.95%

\* Includes the effect of SFAS 115 in the amount of \$(70,000) in 2006, \$(524,000) in 2005, and \$1,030,000 in 2004.

During 1999, the company implemented a Dividend Reinvestment Plan which has resulted in an influx to capital of \$13.3 million to date. The company also adopted stock option plans for directors and senior officers. New capital generated from the exercise of stock options is \$3.8 million at December 31, 2006. In February 2006, the company declared a 10% stock dividend payable March 31, 2006, resulting in the issuance of 1,112,868 new shares. The company has also paid 100% stock dividends on September 30, 2004 and January 31, 2003 which resulted in 5,423,425 and 2,603,838 new shares, respectively. At the 2005 Annual Meeting, shareholders approved management's proposal to increase the number of authorized shares of common stock from 20,000,000 to 50,000,000 shares.

In 2006, regulatory capital increased \$12.1 million comprised of a \$6.1 million increase in retained earnings after paying cash dividends of \$5.8 million and accounting for the 10% stock dividend paid March 31, 2006, a \$3.3 million increase due to the company's dividend reinvestment plan and a \$.9 million increase due to the issuance of shares from the company's stock option plans. As of December 31, 2006, there were 36,780,372 shares of stock available for future sale or stock dividends. The number of shareholders of record at December 31, 2006 was 1,523. Quarterly market highs and lows, dividends paid and known market makers are highlighted in the Investor Information section of this Annual Report. Refer to Note 15 to the financial statements for further discussion of capital requirements and dividend limitations.

### ECONOMIC CONDITIONS AND FORWARD OUTLOOK

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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



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and the credit risk inherent in the loan portfolio in order to minimize the effects of fluctuations caused by changes in general economic conditions.

While we are optimistic about the prospect of continued growth and earnings improvement, any forward-looking statements by their nature are subject to assumptions, risks and uncertainties. Actual results could vary from those implied for a variety of reasons including:

A change in interest rates which is more immediate or more significant than anticipated.

The demand for new loans and the ability of borrowers to repay outstanding debt.

The timing of expansion plans could be altered by forces beyond our control such as weather or regulatory approvals.

Our ability to continue to attract new deposits from our marketplace to meet the daily liquidity needs of the company.

As of this writing, the company was not aware of any pronouncements or legislation that would have a material impact on the results of operations.

### Item 7A Quantitative and Qualitative Disclosures About Market Risk

#### ASSET AND LIABILITY MANAGEMENT

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 company manages these objectives through its Senior Management and Asset and Liability Management Committees (ALCO). 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 company's earnings sensitivity to changes in these rates.

#### INTEREST RATE SENSITIVITY

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. Interest rate risk arises from mismatches in the repricing of assets and liabilities within a given time period. Gap analysis is an approach used to quantify these differences. A positive gap results when the amount of interest-sensitive assets exceeds that of interest-sensitive liabilities within a given time period. A negative gap results when the amount of interest-sensitive liabilities exceeds that of interest-sensitive assets.

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While gap analysis is a general indicator of the potential effect that changing interest rates may have on net interest income, the gap report has some limitations and does not present a complete picture of interest rate sensitivity. First, changes in the general level of interest rates do not affect all categories of assets and liabilities equally or simultaneously. Second, assumptions must be made to construct a gap table. For example, non-maturity deposits are assigned a repricing interval based on internal assumptions. Management can influence the actual repricing of these deposits independent of the gap assumption. Third, the gap table represents a one-day position and cannot incorporate a changing mix of assets and liabilities over time as interest rates change.

Because of the limitations of the gap reports, the company 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.

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### INTEREST RATE GAP

The following schedule illustrates the company's interest rate gap position as of December 31, 2006 which measures sensitivity to interest rate fluctuations for certain interest sensitivity periods.

Interest Rate Sensitivity Analysis  
as of December 31, 2006  
(in thousands)

	Rate Sensitive					Not Rate Sensitive	Total
	1 to 90 Days	91 to 180 Days	181 to 365 Days	1 to 5 Years	Beyond 5 Years		
Commercial loans	\$431,105	\$12,015	\$23,820	\$150,683	\$ 28,286	\$ 0	\$645,909
Mortgage loans	912	1,330	3,393	20,061	9,642	0	35,338
Installment loans	16,018	7,942	18,308	89,640	23,504	0	155,412
Total Loans	448,035	21,287	45,521	260,384	61,432	0	836,659
Securities-taxable	25,488	3,919	13,134	81,192	63,097	8,178	195,008
Securities-tax free	1,905	630	2,820	34,475	35,595	0	75,425
Total Securities	27,393	4,549	15,954	115,667	98,692	8,178	270,433
Interest-bearing deposits with banks	0	0	0	0	0	0	0
Federal funds sold	2,325	0	0	0	0	0	2,325
Total Money Market Assets	2,325	0	0	0	0	0	2,325
Total Earning Assets	477,753	25,836	61,475	376,051	160,124	8,178	1,109,417
Non-earning assets	0	0	0	0	0	82,904	82,904
Allowance for credit losses	0	0	0	0	0	(7,538)	(7,538)
Total Assets	\$477,753	\$25,836	\$61,475	\$376,051	\$160,124	\$83,544	\$1,184,783
Interest-bearing demand deposits	\$291,400	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$291,400
Savings deposits	72,408	0	797	0	0	0	73,205
Time deposits \$100,000 and over	133,094	12,962	21,558	19,916	354	0	187,884
Other time deposits	114,929	37,921	45,826	78,883	4,550	0	282,109
Total Interest-Bearing Deposits	611,831	50,883	68,181	98,799	4,904	0	834,598
Borrowed funds and other interest-bearing liabilities	25,105	1,062	1,964	89,247	35,494	0	152,872
Total Interest-Bearing Liabilities	636,936	51,945	70,145	188,046	40,398	0	987,470
Demand deposits	0	0	0	0	0	86,375	86,375
Other liabilities	0	0	0	0	0	14,076	14,076
Stockholders' equity	0	0	0	0	0	96,862	96,862
Total Liabilities and Stockholders' Equity	\$636,936	\$51,945	\$70,145	\$188,046	\$40,398	\$197,313	\$1,184,783
Interest Rate Sensitivity gap	\$(159,183)	\$(26,109)	\$(8,670)	\$188,005	\$119,726	\$(113,769)	
Cumulative gap	\$(159,183)	\$(185,292)	\$(193,962)	\$(5,957)	\$113,769		



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### EARNINGS AT RISK AND ECONOMIC VALUE AT RISK SIMULATIONS

The company recognizes that more sophisticated tools exist for measuring the interest rate risk in the balance sheet beyond static gap analysis. Although it will continue to measure its static gap position, the company utilizes additional modeling for identifying and measuring the interest rate risk in the overall balance sheet. The ALCO is responsible for focusing on earnings at risk and economic value at risk, and how both relate to the risk-based capital position when analyzing the interest rate risk.

#### EARNINGS AT RISK

Earnings at risk simulation measures the change in net interest income and net income should interest rates rise and fall. The simulation recognizes that not all assets and liabilities reprice equally and simultaneously with market rates (i.e., savings rate). The ALCO looks at earnings at risk to determine income changes from a base case scenario under an increase and decrease of 200 basis points in the interest rate simulation model.

#### ECONOMIC VALUE AT RISK

Earnings at risk simulation measures the short-term risk in the balance sheet. Economic value (or portfolio equity) at risk measures the long-term risk by finding the net present value of the future cash flows from the company's existing assets and liabilities. The ALCO examines this ratio monthly utilizing a rate shock of  $\pm 200$  basis points in the interest rate simulation model. The ALCO recognizes that, in some instances, this ratio may contradict the earnings at risk ratio.

The following table illustrates the simulated impact of a 200 basis point upward or downward movement in interest rates on net interest income, and the change in economic value. This analysis assumed that interest-earning asset and interest-bearing liability levels at December 31, 2006 remained constant. The impact of the rate movements were developed by simulating the effect of rates changing over a twelve-month period from the December 31, 2006 levels.

	RATES + 200	RATES - 200
Earnings at risk:		
Percent change in net interest income	(3.96)%	(2.48)%
Economic value at risk:		
Percent change in economic value of equity	(16.49)%	12.13%

Economic value has the most meaning when viewed within the context of risk-based capital. Therefore, the economic value may change beyond the company's policy guideline for a short period of time as long as the risk-based capital ratio is greater than 10%.

#### 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 company's credit customers and the withdrawal and maturity requirements of its deposit customers, as well as to meet other financial commitments. Cash and cash equivalents (cash and due from banks and federal funds sold) are the company's most liquid assets. At December 31,

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2006 cash and cash equivalents totaled \$28.7 million, compared to the December 31, 2005 level of \$21.9 million. Financing activities provided \$157.2 million and operating activities provided \$19.8 million of cash and cash equivalents during the year while investing activities utilized \$170.2 million. The cash flows provided by financing activities is due primarily to an increase in deposits while the funds provided by operating activities pertains to interest payments received on loans and investments. The cash used in investing activities consists of loan proceeds and security purchases.

Core deposits, which represent the company's primary source of liquidity, averaged \$648 million in 2006, an increase of \$62 million, or 11%, from the \$586 million average in 2005. This increase in average core deposits was supplemented with a \$36 million increase in average jumbo certificates and a \$7 million increase in average borrowed funds and other interest-bearing liabilities.

The company has other potential sources of liquidity, including repurchase agreements. Additionally, the company can borrow on credit lines established at several correspondent banks, the Federal Home Loan Bank of Pittsburgh and the Federal Reserve Discount Window.

### Item 8 - Financial Statements and Supplementary Data

The information required by this item is set forth on pages 34-48 of the Company's 2006 Annual Report to Shareholders, which pages are included as Exhibit 13 hereto, and incorporated herein by reference.

### Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not Applicable

### Item 9A. Controls and Procedures

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures* - The company carried out an evaluation, under the supervision and with the participation of the company's management, including the company's Chief Executive Officer along with the company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon that evaluation, the company's Chief Executive Officer along with the company's Chief Financial Officer concluded that as of December 31, 2006 the company's disclosure controls and procedures are effective in timely alerting them to material information relating to the company (including its consolidated subsidiaries) required to be included in the company's periodic SEC filings.

*Changes in Internal Controls over Financial Reporting* - There were no changes in our internal control over financial reporting that occurred during the period covered by this annual report that have materially affected, or are, reasonably likely to materially affect, the company's internal controls over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

The management of First National Community Bancorp, Inc. (the Company) is responsible for (1) the preparation of the accompanying financial statements; (2) establishing and maintaining internal controls over financial reporting; and (3) the assessment of the effectiveness of internal control over financial reporting. The Securities and Exchange Commission defines effective internal control over financial reporting as a process designed under the supervision of the company's principal executive officer and principal financial officer, and implemented in conjunction with management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles.

The company's internal control over financial reporting is supported by written policies and procedures. All internal control systems, no matter how well designed, have inherent limitations and provide only reasonable assurance that the objectives of the control system are met. Therefore, no evaluation of controls can provide absolute assurance that all control issues and misstatements due to error or fraud, if any, within the company have been detected. Additionally, any system of controls is subject to the risk that controls may become inadequate due to changes in conditions or that compliance with policies or procedures may deteriorate.

As of December 31, 2006, management of the company conducted an assessment of the effectiveness of the company's internal control over financial reporting based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has concluded that the company's internal control over financial reporting was effective as of December 31, 2006.

Management's assessment of the effectiveness of the company's internal control over financial reporting as of December 31, 2006, has been audited by Demetrius and Company, L.L.C., the independent registered public accounting firm that audited the company's financial statements for the period covered. A copy of the Demetrius and Company, L.L.C. report is included in this annual report.

/s/ J. David Lombardi  
J. David Lombardi  
President and Chief Executive Officer

/s/ William Lance  
William S. Lance  
Principal Financial Officer



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and

Stockholders of First National Community Bancorp, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that First National Community Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). First National Community Bancorp, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that First National Community Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, First National Community Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2006 and 2005 and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2006 of First National Community Bancorp, Inc., and our report dated March 14, 2007 expressed an unqualified opinion.

DEMETRIUS & COMPANY, L.L.C.

Wayne, New Jersey

March 14, 2007

Item 9B. Other Information

None

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FIRST NATIONAL COMMUNITY BANCORP, INC.

### Part III.

#### Item 10 Directors, Executive Officers and Corporate Governance

Information regarding directors, nominees, principal officers, audit committees and audit committee financial experts required by this item is set forth under the captions Information as to Nominees and Directors , Principal Officers of the Company , Principal Officers of the Bank , Information about the Company s Audit Committee and its Charter , and Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated herein by reference.

The company has adopted a Code of Ethics that applies to directors, officers and employees of the company and the bank. A copy of the Code of Ethics was included as an exhibit to the company s Form 10-K for the year ended December 31, 2005 and filed with the Securities and Exchange Commission. A request for the Company s Code of Ethics can be made either in writing to William Lance, First National Community Bancorp, Inc., 102 East Drinker Street, Dunmore, Pennsylvania, 18512 or by email at fncb@fncb.com.

#### Item 11 - Executive Compensation

The information required by this item is set forth under the captions Executive Compensation , Option Grants in 2006 , Compensation of Directors , Employment Agreement , Compensation Committee Report , and Board of Directors Interlocks and Insider Participation in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated herein by reference.

#### Item 12- Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item regarding security ownership of certain beneficial owners and management is set forth under the caption Principal Beneficial Owners of the Company s Common Stock in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated herein by reference.

Information regarding the Company s compensation plans under which equity securities of the registrant are authorized for issuance as of December 31, 2006 is set forth under the caption Equity Compensation Plan Information in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated herein by reference.

#### Item 13 - Certain Relationships and Related Transactions and Director Independence

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The information required by this item is set forth under the captions Certain Relationships and Related Transactions and Governance of the Company in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated herein by reference.

### Item 14 Principal Accountant Fees and Services

The information required by this item is set forth under the caption Independent Auditors in the Proxy Statement filed for the annual meeting of shareholders to be held on May 16, 2007 and is incorporated herein by reference.

Part IV.

Item 15 Exhibits and Financial Statement Schedules

1. Financial Statements

The following financial statements are included by reference in Part II, Item 8 hereof:

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheet  
Consolidated Statement of Income  
Consolidated Statement of Stockholders' Equity  
Consolidated Statement of Cash Flows  
Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Financial Statement Schedules are omitted because the required information is either not applicable, not required or is shown in the respective financial statements or in the notes thereto.

3. The following Exhibits are filed herewith or incorporated by reference:

- EXHIBIT 3.1 Articles of Incorporation filed as Exhibit 3.1 to the Company's Form 10-K for the year ended December 31, 2005 is hereby incorporated by reference
- EXHIBIT 3.2 By-laws - filed as Exhibit 3.2 to the Company's Form 10-K for the year ended December 31, 2005 is hereby incorporated by reference
- EXHIBIT 10.1 Dividend Reinvestment Plan filed as Exhibit 10.1 to the Company's Form 10-K for the year ended December 31, 2004 is hereby incorporated by reference
- EXHIBIT 10.2 Stock Incentive Plan - filed as Exhibit 10.2 to the Company's Form 10-K for the year ended December 31, 2004 is hereby incorporated by reference
- EXHIBIT 10.3 Stock Option Plan - filed as Exhibit 10.3 to the Company's Form 10-K for the year ended December 31, 2004 is hereby incorporated by reference
- EXHIBIT 10.4 Deferred Compensation Plan - filed as Exhibit 10.4 to the Company's Form 10-K for the year ended December 31, 2004 is hereby incorporated by reference
- EXHIBIT 21 Subsidiaries
- EXHIBIT 13 Annual Report
- EXHIBIT 14 Code of Ethics - filed as Exhibit 14 to the Company's Form 10-K for the year ended December 31, 2005 is hereby incorporated by reference
- EXHIBIT 31.1 Certification of Chief Executive Officer
- EXHIBIT 31.2 Certification of Chief Financial Officer
- EXHIBIT 32.1 Section 1350 Certification - Chief Executive Officer

EXHIBIT 32.2      Section 1350 Certification    Chief Financial Officer

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Pursuant to the requirements of Section 13 or 15(d) 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.

/s/ J. David Lombardi  
J. David Lombardi, President and  
Chief Executive Officer

/s/ William Lance  
William Lance, Treasurer  
Principal Financial Officer and  
Principal Accounting Officer

/s/ Linda D. Amario  
Linda D. Amario  
Comptroller

DATE: March 14, 2007

Pursuant to the requirements of the Securities Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Directors:

/s/ Michael G. Cestone  
Michael G. Cestone

March 14, 2007  
Date

/s/ Louis A. DeNaples  
Louis A. DeNaples

March 14, 2007  
Date

Michael J. Cestone, Jr.

Date

Joseph J. Gentile

Date

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/s/ Joseph Coccia Joseph Coccia	March 14, 2007 Date	Joseph O. Haggerty	Date
/s/ William P. Conaboy William P. Conaboy	March 14, 2007 Date	/s/ J. David Lombardi J. David Lombardi	March 14, 2007 Date
/s/ Michael T. Conahan Michael T. Conahan	March 14, 2007 Date	/s/ John P. Moses John P. Moses	March 14, 2007 Date
/s/ Dominick L. DeNaples Dominick L. DeNaples	March 14, 2007 Date	John R. Thomas	Date