FNB BANCORP/CA/
Form 10-Q
August 13, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

Quarterly Report
Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2010

FNB BANCORP
(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of incorporation)

000-49693	92-2115369
(Commission File Number)	(IRS Employer Identification No.)

975 El Camino Real, South San Francisco, California	94080
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (650) 588-6800

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
o Yes o No

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock as of August 3, 2010: 3,181,714 shares.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

FNB BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(Dollar amounts in thousands)		June 30, 2010		December 31, 2009
ASSETS				
Cash and due from banks	$	60,876	$	62,853
Securities available-for-sale		125,976		97,188
Loans, net of allowance for loan losses of $9,076 and $9,829 on June 30, 2010 and December 31, 2009		480,652		494,349
Bank premises, equipment, and leasehold improvements, net		11,762		11,784
Other real estate owned		8,677		7,320
Goodwill		1,841		1,841
Accrued interest receivable and other assets		32,027		32,974
Total assets	$	721,811	$	708,309
LIABILITIES AND STOCKHOLDERS’ EQUITY				
Deposits				
Demand, noninterest bearing		125,455		120,515
Demand, interest bearing		60,929		57,368
Savings and money market		313,613		293,758
Time		120,169		127,323
Total deposits		620,166		598,964
Federal Home Loan Bank advances		15,000		25,000
Accrued expenses and other liabilities		5,977		5,480
Total liabilities		641,143		629,444
Stockholders’ equity				
Preferred stock - series A - no par value, authorized and outstanding 12,000 shares (liquidation preference of $1,000 per share plus accrued dividends)		11,640		11,534
Preferred stock - series B - no par value, authorized and outstanding 600 shares (liquidation preference of $1,000 per share plus accrued dividends)		622		629
Common stock, no par value, authorized 10,000,000 shares; issued and outstanding 3,181,714 shares at June 30, 2010 and December 31, 2009		45,128		45,044
Retained earnings		21,944		20,945
Accumulated other comprehensive income		1,334		713
Total stockholders’ equity		80,668		78,865

Total liabilities and stockholders' equity	$	721,811	$	708,309

See accompanying notes to consolidated financial statements.

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FNB BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF EARNINGS
(UNAUDITED)
(Dollars in thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Interest income:				
Interest and fees on loans	$7,954	$7,841	$15,936	$15,818
Interest on taxable securities	504	438	941	970
Interest on tax-exempt securities	298	354	539	706
Federal funds sold	—	10	—	60
Total interest income	8,756	8,643	17,416	17,554
Interest expense:				
Deposits	1,223	1,729	2,663	3,387
Federal Home Loan Bank advances	107	633	367	1,294
Total interest expense	1,330	2,362	3,030	4,681
Net interest income	7,426	6,281	14,386	12,873
Provision for loan losses	315	760	565	2,900
Net interest income after provision for loan losses	7,111	5,521	13,821	9,973
Noninterest income:				
Service charges	674	699	1,359	1,427
Credit card fees	162	173	314	338
Gain on sale of securities	54	242	162	246
Gain on sale of other real estate owned	1	—	25	—
Other income	135	131	266	583
Total noninterest income	1,026	1,245	2,126	2,594
Noninterest expense:				
Salaries and employee benefits	3,478	3,303	6,980	6,750
Loss on impairment of other real estate owned	486	163	647	1,363
Occupancy expense	505	523	1,017	1,035
Equipment expense	511	475	1,023	957
Professional fees	320	289	579	625
FDIC assessment	363	499	623	657
Telephone, postage and supplies	267	259	545	532
Other real estate owned expense	414	383	612	504
Bankcard expenses	150	163	289	317
Other expense	743	701	1,460	1,438
Total noninterest expense	7,237	6,758	13,775	14,178
Earnings (loss) before income tax expense (benefit)	900	8	2,172	(1,611)
Income tax expense (benefit)	161	4	429	(426)
Net earnings (loss)	739	4	1,743	(1,185)
Dividends and discount accretion on preferred stock	214	189	426	205
Net earnings (loss) available to common stockholders	$525	$(185)	$1,317	$(1,390)

Earnings (loss) per share data:				
Basic	$0.16	$(0.06)	$0.41	$(0.44)
Diluted	$0.16	$(0.06)	$0.41	$(0.44)
Weighted average shares outstanding:				
Basic	3,182	3,182	3,182	3,182
Diluted	3,192	3,182	3,192	3,182

See accompanying notes to consolidated financial statements.

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FNB BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

(Dollar amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net earnings (loss)	$739	$4	$1,743	$(1,185)
Unrealized gain (loss) on AFS securities	698	(198)	717	(293)
Reclassification adjustment for gain on available- for-sale securities sold, net of tax	(32)	(143)	(96)	(143)
Total comprehensive income (loss)	$1,405	$(337)	$2,364	$(1,621)

See accompanying notes to consolidated financial statements.

FNB BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(Dollar amounts in thousands)	Six months ended June 30	
	2010	2009
Cash flow from operating activities:		
Net earnings (loss)	$1,743	$(1,185)
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:		
Gain on sale of securities available-for-sale	(162)	(246)
Depreciation, amortization and accretion	1,178	1,003
Gain on sale of other real estate owned	(25)	—
Stock-based compensation expense	84	58
Provision for loan losses	565	2,900
Decrease in interest receivable and other assets	950	1,909
Valuation allowance on other real estate owned	647	1,363
Increase in accrued expenses and other liabilities	65	319
Net cash provided by operating activities	5,045	6,121
Cash flows from investing activities		
Purchase of securities available-for-sale	(65,519)	(23,579)
Proceeds from matured/called/sold securities available-for-sale	37,500	32,532
Proceeds from sale of other real estate owned	1,672	—
Net investment in other real estate owned	(468)	—
Net decrease in loans	9,949	4,474
Purchases of bank premises, equipment, leasehold improvements	(713)	(135)
Net cash (used in) provided by investing activities	(17,579)	13,292
Cash flows from financing activities		
Net increase in demand and savings deposits	28,356	45,615
Net decrease in time deposits	(7,154)	(8,047)
Net decrease in Federal Home Loan Bank advances	(10,000)	(46,100)
Dividends paid on common stock	(318)	(909)
Dividends paid on preferred stock series A and B	(327)	(141)
Issuance of preferred stock series A	—	11,360
Issuance of preferred stock series B	—	640
Net cash provided by financing activities	10,557	2,418
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,977)	21,831
Cash and cash equivalents at beginning of period	62,853	14,865
Cash and cash equivalents at end of period	$60,876	$36,696
Additional cash flow information:		
Interest paid	$3,232	$4,961
Income taxes paid	132	123
Non-cash investing and financing activities:		
Accrued dividends	159	152
Change in unrealized gain (loss) in available for-sale securities	621	(436)

Loans transferred to other real estate owned	3,183	3,298

See accompanying notes to consolidated financial statements.

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FNB BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(UNAUDITED)

NOTE A – BASIS OF PRESENTATION

FNB Bancorp (the "Company") is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was incorporated under the laws of the State of California on February 28, 2001. The consolidated financial statements include the accounts of FNB Bancorp and its wholly owned subsidiary, First National Bank of Northern California (the "Bank"). The Bank provides traditional banking services in San Mateo and San Francisco counties.

All intercompany transactions and balances have been eliminated in consolidation. The financial statements include all adjustments of a normal and recurring nature, which are, in the opinion of management, necessary for a fair presentation of the financial results for the interim periods, as required by Regulation S-X, Rule 10-01.

The accompanying unaudited financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all information and footnotes normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America. Accordingly, these financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2009.

Results of operations for interim periods are not necessarily indicative of results for the full year.

NOTE B – STOCK OPTION PLANS

Stock option expense is recorded based on the fair value of option contracts issued. The fair value is determined by the expected contract term, the risk free interest rate, the volatility of the Company's stock price and the level of dividends the Company is expected to pay.

The expected term of options granted is derived from historical plan behavior and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U. S. Treasury yield curve in effect at the time of the grant.

The amount of compensation expense for options recorded in the quarters ended June 30, 2010 and June 30, 2009 was $42,000 and $29,000, respectively. There was no income tax benefit recognized in the income statements for these amounts for the quarters ended June 30, 2010, and June 30, 2009, respectively. The amount of compensation expense for options recorded in the six months ended June 30, 2010 and June 30, 2009 was $84,000 and $58,000, respectively. There was no income tax benefit recognized in the statements of earnings for these amounts for the six months ended June 2010 and 2009, respectively.

There was no intrinsic value for options exercisable or exercised during the quarter and six months ended June 30, 2010.

The amount of total unrecognized compensation expense related to non-vested options at June 30, 2010 was $506,000, and the weighted average period over which it will be amortized is 2.6 years.

NOTE C – EARNINGS (LOSS) PER SHARE CALCULATION

Earnings (loss) per common share (EPS) is computed based on the weighted average number of common shares outstanding during the period. Basic EPS excludes dilution and is computed by dividing net earnings available to common stockholders (after deducting dividends and related accretion on preferred stock) by the weighted average of common shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. All common stock equivalents are anti-dilutive when a net loss occurs.

Earnings (loss) per share have been computed based on the following :

(Dollar amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net earnings (loss)	$739	$4	$1,743	$(1,185)
Dividends and discount accretion on preferred stock	214	189	426	205
Net earnings (loss) available to common shareholders	$525	$(185)	$1,317	$(1,390)
Average number of shares outstanding	3,182	3,182	3,182	3,182
Effect of dilutive options	10	—	10	—
Average number of shares outstanding used to calculate diluted earnings per share	3,192	3,182	3,192	3,182
Anti-dilutive options not included	322,797	335,075	322,797	335,075

NOTE D – SECURITIES AVAILABLE FOR SALE

The amortized cost and carrying values of securities available-for-sale are as follows:

(Dollar amounts in thousands)	Amortized cost	Unrealized gains	Unrealized losses	Carrying value
June 30, 2010				
U. S. Treasury securities	$9,162	$145	$—	$9,307
Obligations of U.S. Government agencies	51,019	712	—	51,731
Mortgage backed securities	22,626	456	(11)	23,071
Obligations of states and political subdivisions	36,220	948	(33)	37,135
Corporate debt	4,688	44	—	4,732
	$123,715	$2,305	$(44)	$125,976

(Dollar amounts in thousands)	Amortized cost	Unrealized gains	Unrealized losses	Carrying value
December 31, 2009:				
Obligations of U.S. Government agencies	$45,100	$274	$(67)	$45,307
Mortgage-backed securities	22,185	238	(144)	22,279
Obligations of states and political subdivisions	24,998	887	(18)	25,867
Corporate debt	3,696	41	(2)	3,735
	$95,979	$1,440	$(231)	$97,188

An analysis of gross unrealized losses within the available-for-sale investment securities portfolio as of June 30, 2010 and December 31, 2009 follows.

(Dollar amounts in thousands)	Total Fair Value	Less than 12 Months Unrealized Losses	Total Fair Value	12 Months or Longer Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2010						
U. S. Treasury securities	$ —	$ —	$ —	$ —	$ —	$ —
Obligations of U.S. Government agencies	—	—	—	—	—	—
Mortgage backed securities	3,457	(11)	—	—	3,457	(11)
Obligations of states and political subdivisions	4,559	(27)	450	(6)	5,009	(33)
Corporate debt			—	—		
Total	$ 8,016	$ (38)	$ 450	$ (6)	$ 8,466	$ (44)

December 31, 2009: (Dollar amounts in thousands)	Total Fair Value	< 12 Months Unrealized Losses	Total Fair Value	12 Months or > Unrealized Losses	Total Fair Value	Total Unrealized Losses
	$ 12,252	$ (67)	$ —	$ —	$ 12,252	$ (67)

Obligations of U.S. Government agencies						
Mortgage-backed securities	14,332	(144)	—	—	14,332	(144)
Obligations of states and political subdivisions	1,502	(7)	439	(11)	1,941	(18)
Corporate debt	1,058	(2)	—	—	1,058	(2)
Total	$ 29,144	$ (220)	$ 439	$ (11)	$ 29,583	$ (231)

At June 30, 2010, there were two securities in an unrealized loss position for greater than 12 consecutive months. Management periodically evaluates each security in an unrealized loss position to determine if the impairment is temporary or other-than-temporary. Management has determined that no investment security is other-than-temporarily impaired at June 30, 2010. The unrealized losses are due solely to interest rate changes and the Company does not intend to sell nor expects it will be required to sell investment securities identified with impairments prior to the earliest of forecasted recovery or the maturity of the underlying investment security.

The amortized cost and carrying value of debt securities as of June 30, 2010 and December 31, 2009, respectively, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

At June 30, 2010:

(Dollar amounts in thousands)	Amortized Cost	Carrying Value
Available-for-sale:		
Due in one year or less	$4,376	$4,439
Due after one through five years	78,231	79,724
Due after five years through ten years	8,457	8,640
Due after ten years	32,651	33,173
	$123,715	$125,976

At December 31, 2009:

(Dollar amounts in thousands) December 31, 2009	Amortized Cost	Carrying Value
Available-for-sale:		
Due in one year or less	$9,133	$9,184
Due after one through five years	57,676	58,584
Due after five years through ten years	5,963	6,087
Due after ten years	23,207	23,333
	$95,979	$97,188

For the six months ended June 30, 2010, gross realized gains amounted to $162,000 on the sale of $25,297,000 in securities. For the six months ended June 30, 2009, gross realized gains amounted to $246,000 on the sale of $8,881,000 in securities.

At June 30, 2010, securities with an amortized cost of $93,416,000 and fair value of $95,334,000 were pledged as collateral for public deposits and for other purposes required by law.

At June 30, 2010, the Bank had investments in Federal Reserve Bank stock classified as other assets in the accompanying balance sheet of $1,062,000. These investments in Federal Reserve Bank stock are carried at cost, and evaluated periodically for impairment.

NOTE E – FAIR VALUE MEASUREMENT

The following tables present information about the Company's assets and liabilities measured at fair value as of June 30, 2010, and indicate the fair value techniques used by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following table presents the recorded amounts of assets measured at fair value on a recurring basis:

(Dollar amounts in thousands)		Fair Value Measurements at June 30, 2010, Using		
Description	Fair Value 6/30/2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U. S. Treasury securities	$ 9,307	$ 9,307	$ —	$ —
Obligations of U.S. Government agencies	51,731	—	51,731	—
Mortgage-backed securities	23,071	—	23,071	—
Obligations of states and political subdivisions	37,135	—	37,135	—
Corporate debt	4,732	—	4,732	—
Total assets measured at fair value	$ 125,976	$ 9,307	$ 116,669	$ —

(Dollar amounts in thousands)		Fair Value Measurements at December 31, 2009, Using		
Description	Fair Value 12/31/2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$ 97,188	$ —	$ 97,188	$ —
Total assets measured at fair value	$ 97,188	$ —	$ 97,188	$ —

Fair values established for available-for-sale investment securities are based on estimates of fair values quoted for similar types of securities with similar maturities, risk and yield characteristics.

The following table presents the recorded amount of assets measured at fair value on a non-recurring basis:

(Dollar amounts in thousands)		Fair Value Measurements at June 30, 2010, Using			
Description	Fair Value 6/30/10	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total losses
Impaired loans	$ 12,117	$ —	$ —	$ 12,117	$ 759
Other real estate owned	4,251	—	—	4,251	486
Total impaired assets measured at fair value	$ 16,368	$ —	$ —	$ 16,368	$ 1,245

(Dollar amounts in thousands)		Fair Value Measurements at December 31, 2009, Using			
Description	Fair Value 12/31/2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total losses
Impaired loans	$23,743	$—	$—	$ 23,743	$2,875
Other real estate owned	7,320	—	—	7,320	1,831
Total impaired assets measured at fair value	$31,063	$—	$—	$ 31,063	$4,706

The Bank does not record loans at fair value. However, from time to time, if a loan is considered impaired, a specific allocation within the allowance for loan losses may be required. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and cash flows. Those impaired loans not requiring an allowance represent loans for which the value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral or when the impaired loan has been written down to fair value require classification in the fair value hierarchy. If the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loans as nonrecurring Level 3. When an appraised value is not available, or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank also records the impaired loans as nonrecurring Level 3.

Other real estate owned is carried at the lower of historical cost or fair market value. An appraisal (a Level 3 valuation) is obtained at the time the Company acquires property through the foreclosure process. Any loan balance outstanding that exceeds the appraised value of the property is charged off against the allowance for loan loss at the

time the property is acquired. Subsequent to acquisition, the Bank updates the property's appraised value on at least an annual basis. If the value of the property has declined during the year, a loss due to valuation impairment charge is recorded along with a corresponding reduction in the book carrying value of the property.

Fair Values of Financial Instruments.

The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments:

Cash and Cash Equivalents.

The carrying amounts reported in the balance sheet for cash and short-term instruments are a reasonable estimate of fair value, which will approximate their historical cost.

Securities Available-for-Sale.

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans Receivable.

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values and credit risk factors. For fixed rate loans, fair values are based on discounted cash flows, credit risk factors, and liquidity factors.

Bank Owned Life Insurance.

The fair value of bank owned life insurance is the cash surrender value of the policies.

Deposit liabilities.

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are based on discounted cash flows.

Federal Home Loan Bank Advances.

The fair values of Federal Home Loan Bank Advances are based on discounted cash flows.

Undisbursed loan commitments, lines of credit, Mastercard line and standby letters of credit.

The fair value of these off-balance sheet items are based on discounted cash flows of expected fundings.

The following table provides summary information on the estimated fair value of financial instruments at June 30, 2010:

(Dollar amounts in thousands)	Carrying amount	Fair value
Financial assets:		
Cash and cash equivalents	$60,876	$60,876
Securities available for sale	125,976	125,976
Loans, gross, net	489,728	485,908
Bank owned life insurance	9,025	9,025
Financial liabilities:		
Deposits	620,166	626,453
Federal Home Loan Bank advances	15,000	15,118
Off-balance-sheet liabilities:		
Undisbursed loan commitments, lines of credit, standby letters of credit and Mastercard lines of credit	—	923

The carrying amount of loans include $14,098,000 of nonaccrual loans (loans that are not accruing interest) as of June 30, 2010. Management has determined that primarily because of the uncertainty of predicting an observable market interest rate, excessive amounts of time and money would be incurred to estimate the fair values of nonperforming loans. As such, these loans are recorded at their carrying amount in the estimated fair value columns.

The following table provides summary information on the estimated fair value of financial instruments at December 31, 2009:

(Dollar amounts in thousands)	Carrying amount	Fair value
Financial assets:		
Cash and cash equivalents	$62,853	$62,853
Securities available for sale	97,188	97,188
Loans, gross	504,178	499,291
Bank owned life insurance	8,866	8,866
Financial liabilities:		
Deposits	598,964	599,619
Federal Home Loan Bank advances	25,000	25,295
Off-balance-sheet liabilities:		
Undisbursed loan commitments, lines of credit, standby letters of credit and Mastercard lines of credit	—	902

NOTE F – PREFERRED STOCK

Preferred Stock was issued to the U. S. Treasury as part of the Treasury’s Capital Purchase Program. The Preferred Stock consists of two issues, Series A and Series B. The Series A and Series B Preferred Stock are both carried at liquidation value less discounts received plus premiums paid that are amortized over the expected timeframe that the Preferred Shares will be outstanding using the level yield method. The Series A and Series B Preferred Stock must be

redeemed after ten years. The Series A Preferred Stock carries a dividend yield of 5% for the first five years. Beginning in year six, the dividend increases to 9% and continues at this rate until repaid. The Series B Preferred Stock pays a 9% dividend until repaid. Allocation of proceeds between the two issues was done in such a manner that the blended level yield of both issues would be 6.83% to the expected repayment date, which is currently anticipated to be three years from the date of issue. Operating restrictions related to the preferred stock are documented on the U. S. Department of the Treasury's website and include restrictions on dividend payments and executive compensation, the establishment of the requirement that the Preferred Stock be repaid first with the proceeds from any future capital offering before any other use of the proceeds is allowed, establishment of additional reporting requirements related to lending activity of the Bank during the time the Preferred Stock is outstanding, and the execution of documents that allow the U. S. Department of the Treasury to add or change the conditions related to the issuance of the Preferred Stock unilaterally, at their discretion. In addition, beginning in the second quarter of 2010, the Company must obtain regulatory approval from the OCC before TARP dividends can be paid. As of June 30, 2010, all dividend payments on our Preferred Stock have been paid in accordance with the Treasury's Capital Purchase Program.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-Looking Information and Uncertainties Regarding Future Financial Performance.

This report, including management's discussion below, concerning earnings and financial condition, contains "forward-looking statements." Forward-looking statements are estimates of or statements about expectations or beliefs regarding the Company's future financial performance or anticipated future financial condition that are based on current information and that are subject to a number of risks and uncertainties that could cause actual operating results in the future to differ significantly from those expected at the current time. Those risks and uncertainties include, although they are not limited to, the following:

Increased Competition. Increased competition from other banks and financial service businesses, mutual funds and securities brokerage and investment banking firms that offer competitive loan and investment products and competitive market pricing, which could require us to reduce interest rates and loan fees to attract new loans or to increase interest rates that we offer on time deposits, either or both of which could, in turn, reduce interest income and net interest margins. These factors could reduce our ability to attract new deposits and loans and leases.

Liquidity Risk. The stability of funding sources and continued availability of borrowings; our ability to raise capital or incur debt on reasonable terms.

Possible Adverse Changes in Economic Conditions. Adverse changes in national or local economic conditions could (i) reduce loan demand which could, in turn, reduce interest income and net interest margins; (ii) adversely affect the financial capability of borrowers to meet their loan obligations, which, in turn, could result in increases in loan losses and require increases in provisions for loan losses, thereby adversely affecting operating results; and (iii) lead to reductions in real property values that, due to the Company's reliance on real property to secure many of its loans, could make it more difficult to prevent losses from being incurred on non-performing loans through the sale of such real properties.

Possible Adverse Changes in National Economic Conditions and Federal Reserve Board Monetary Policies. Changes in national economic policies, such as increases in inflation or declines in economic output often prompt changes in Federal Open Market Committee ("FOMC") monetary policies that could reduce interest income or increase the cost of funds to the Company, either of which could result in reduced earnings. In addition deterioration in economic conditions that could result in increased loan and lease losses.

Changes in Regulatory Policies. Changes in federal and national bank regulatory policies, such as increases in capital requirements or in loan loss reserve or asset/liability ratio requirements, liquidity requirements, and the risks associated with concentration in real estate related loans could adversely affect earnings by reducing yields on earning assets or increasing operating costs. For example, the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act signed by President Obama on July 21, 2010.

Due to these and other possible uncertainties and risks, readers are cautioned not to place undue reliance on the forward-looking statements contained in this report, which speak only as of the date of this report, or to make predictions based solely on historical financial performance. The Company also disclaims any obligation to update forward-looking statements contained in this report.

Critical Accounting Policies And Estimates

Management's discussion and analysis of its financial condition and results of operations are based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to its loans and allowance for loan losses. The Company bases its estimates on current market conditions, historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. All adjustments that, in the opinion of management, are necessary for a fair presentation for the periods presented have been reflected as required by Regulation S-X, Rule 10-01. The Company believes the following critical accounting policy requires significant judgments and estimates used in the preparation of the consolidated financial statements.

Allowance for Loan Losses

The allowance for loan losses is periodically evaluated for adequacy by management. Factors considered include the Company's historical loan loss experience, known and inherent risks in the portfolio, current economic conditions, known adverse situations that may affect the borrower's ability to repay, regulatory policies, and the estimated value of underlying collateral. The evaluation of the adequacy of the allowance is based on the above factors along with prevailing and anticipated economic conditions that may impact borrowers' ability to repay their loans. Determination of the allowance is based upon objective and subjective judgments by management based on the information currently available. Adverse changes in information could result in higher than expected charge-offs and loan loss provisions.

Goodwill

Goodwill arises from the Company’s purchase price exceeding the fair value of the net assets of an acquired business. Goodwill represents the value attributable to intangible elements acquired. The value of goodwill is supported ultimately by profit from the acquired business. A decline in earnings could lead to impairment, which would be recorded as a write-down in the Company’s consolidated statements of income. Events that may indicate goodwill impairment include significant or adverse changes in results of operations of the acquired business or asset, economic or political climate; an adverse action or assessment by a regulator; unanticipated competition; and a more-likely-than-not expectation that a reporting unit will be sold or disposed of at a loss.

Other Than Temporary Impairment

Other than temporary impairment (“OTTI”) is triggered if the Company has the intent to sell the security, it is likely that it will be required to sell the security before recovery, or if the Company does not expect to recover the entire amortized cost basis of the security. If the Company intends to sell the security or it is likely it will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the security and it is not likely that the Company will be required to sell the security but the Company does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings as an OTTI. The credit loss is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected of a security. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment loss related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, would be recognized as a charge to other comprehensive income (“OCI”). Impairment losses related to all other factors are to be presented as a separate category within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the OTTI amount recorded in OCI will increase the carrying value of the investment, and would not affect earnings. If there is an indication of additional credit losses the security is re-evaluated accordingly based on the procedures described above.

Provision for and Deferred Income Taxes

The Company is subject to income tax laws of the United States, its states, and the municipalities in which it operates. The Company considers its income tax provision methodology to be critical, as the determination of current and deferred taxes is based on complex analyses of many factors including interpretation of federal and state laws, the difference between tax and financial reporting bases of assets and liabilities (temporary differences), estimates of amounts due or owed, the timing of reversals of temporary differences and current financial standards. Actual results could differ significantly from the estimates due to tax law interpretations used in determining the current and deferred income tax liabilities. Additionally, there can be no assurances that estimates and interpretations used in determining income tax liabilities may not be challenged by federal and state taxing authorities.

Recent Accounting Pronouncements

In January, 2010, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2010-06, to improve disclosure requirements related to "Fair Value Measurements and Disclosures-Overall Subtopic (Subtopic 820-10)" of the FASB Accounting Standards Codification, which was originally issued as FASB Statement No. 157, Fair Value Measurements. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009 except for the disclosures about purchases, sales, issuances and settlements in the rollforward activity in Level 3 fair value measurements. The new disclosures require separate disclosures regarding transfers in and out of Levels 1 and 2 fair value measurements, and to describe the reasons for the transfers. As to activity in Level 3, a reporting entity is required to present separate information about purchases, sales, issuances and settlements (on a gross basis rather than as one net number).This requires first quarter of 2010 implementation so that investments shown by class and changes or transfers in levels disclosed. The Company only measures investment securities, impaired loans and real estate owned at fair value. Our adoption of this standard update did not have an impact on our financial condition or results of operations.

In February 2010, the FASB issued ASU No. 2010-09, "Subsequent Events (Topic 855)—Amendments to Certain Recognition and Disclosure Requirements." This ASU eliminates the requirement to disclose the date through which a Company has evaluated subsequent events and refines the scope of the disclosure requirements for reissued financial statements. This ASU is effective for the first quarter of 2010. This ASU did not have a material impact on the Company's consolidated financial statements.

In March, the FASB issued ASU No. 2010-11, "Derivatives and Hedging (Topic 815)—Scope Exception Related to Embedded Credit Derivatives." The ASU eliminates the scope exception for bifurcation of embedded credit derivatives in interests in securitized financial assets, unless they are created solely by subordination of one financial instrument to another. The ASU is effective the first quarter beginning after June 15, 2010. The Company has evaluated the impact of adoption and does not expect the ASU will have a material impact on the Company's consolidated financial statements.

In April, the FASB issued ASU No. 2010-18, "Receivables (Topic 310)—Effect of a Loan Modification When the Loan Is Part of a Pool That is Accounted for as a Single Asset." This ASU clarifies that modifications of loans that are accounted for within a pool under Topic 310-30 do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. No additional disclosures are required with this ASU. The amendments in this ASU are effective for modifications of loans accounted for within pools under Topic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. The amendments are to be applied prospectively and early application is permitted. Upon initial adoption of the guidance in this ASU, an entity may make a onetime election to terminate accounting for loans as a pool under Topic 310-30. This election may be applied on a pool-by-pool basis and does not preclude an entity from applying pool accounting to subsequent acquisitions of loans with credit deterioration. The Company has evaluated the impact of adoption and does not expect the ASU will have a material impact on the Company's consolidated financial statements.

In July, the FASB issued ASU No. 2010-20, “Receivables (Topic 310)-Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” The objective of the amendments in this Update is for an entity to provide disclosures that facilitate financial statement users’ evaluation of the following:

1. The nature of credit risk inherent in the entity’s portfolio of financing receivables

2. How that risk is analyzed and assessed in arriving at the allowance for credit losses.

3. The changes and reasons for those changes in the allowance for credit losses.

The disclosures about activity that occurs during a reporting period are effective for interim and annual reports beginning on or after December 15, 2010.

Earnings Analysis

Net earnings for the quarter ended June 30, 2010 were $739,000, compared to net earnings of $4,000 for the quarter ended June 30, 2009, an increase of $735,000, or 18,375%. Cash dividend payments on the preferred shares outstanding were made as scheduled during the quarters ended June 30, 2010 and 2009, respectively. Net earnings for the six months ended June 30, 2010 were $1,743,000 compared to net losses of $1,185,000 for the six months ended June 30, 2009, an improvement of $2,928,000. Net earnings before income tax expense for the quarter ended June 30, 2010 were $900,000, compared to net earnings before income tax expense of $8,000 for the quarter ended June 30, 2009, an increase of $892,000. Net earnings available to common stockholders for the quarter ended June 30, 2010, were $525,000, compared to net losses available to common stockholders of $185,000 for the quarter ended June 30, 2009. Earnings before income tax expense were $2,172,000 for the six months ended June 30, 2010 compared to net losses before income tax expense of $1,611,000 for the six months ended June 30, 2009, an improvement of $3,783,000. Net earnings available to common stockholders were $1,317,000 for the six months ended June 30, 2010, compared to net losses available to common stockholders of $1,390,000 for the six months ended June 30, 2009. The losses for the six months ended June 30, 2009 were primarily the result of an increased provision for loan losses, a special FDIC assessment, and an increased cost of loan collections. Earnings during the three and six months ended June 30, 2010 were positively affected by an increase in our net interest margin and a decrease in our provision for loan losses.

Net interest income for the quarter ended June 30, 2010 was $7,426,000, compared to $6,281,000 for the quarter ended June 30, 2009, an increase of $1,145,000, or 18%. Net interest income for the six months ended June 30, 2010 was $14,386,000 compared to $12,873,000 for the six months ended June 30, 2009, an increase of $1,513,000, or 12%. During the three and six months ended June 30, 2010, the Bank lowered the interest paid on interest bearing liabilities faster than the decrease that occurred in the yield on interest earning assets.

Basic and diluted earnings per share were $0.16 for the second quarter of 2010 compared to basic and diluted losses of $0.06 for the second quarter of 2009. Basic and diluted earnings per share were $0.41 for the six months ended June 30, 2010 compared to basic and diluted losses per share of $0.44 for the six months ended June 30, 2009.

The following table presents an analysis of net interest income and average earning assets and liabilities for the three-and six-month periods ended June 30, 2010 compared to the three-and six-month periods ended June 30, 2009.

TABLE 1

NET INTEREST INCOME AND AVERAGE BALANCES
FNB BANCORP AND SUBSIDIARY

	Three months ended June 30, 2010			2009		
(Dollar amounts in thousands)	Average Balance	Interest	Annualized Average Yield	Average Balance	Interest	Annualized Average Yield
INTEREST EARNING ASSETS						
Loans, gross (1) (2)	$ 494,126	$ 7,954	6.46 %	$ 495,546	$ 7,841	6.35 %
Taxable securities (3)	88,625	504	2.28 %	52,011	438	3.38 %
Nontaxable securities (3)	33,776	395	4.69 %	39,114	462	4.74 %
Fed funds sold	—	—	n/a	21,385	10	0.19 %
Total interest earning assets	616,527	8,853	5.76 %	608,056	8,751	5.77 %
NONINTEREST EARNING ASSETS:						
Cash and due from banks	65,182			24,197		
Premises	11,772			12,596		
Other assets	34,756			28,212		
Total noninterest earning assets	111,710			65,005		
TOTAL ASSETS	$ 728,237			$ 673,061		
INTEREST BEARING LIABILITIES:						
Demand, int bearing	$ 61,552	46	0.30 %	$ 58,911	84	0.57 %
Money market	273,536	769	1.13 %	177,281	924	2.09 %
Savings	43,317	27	0.25 %	43,460	31	0.29 %
Time deposits	121,876	381	1.25 %	136,068	690	2.03 %
Federal Home Loan Bank advances	15,000	107	2.86 %	58,022	633	4.38 %
Total interest bearing liabilities	515,281	1,330	1.04 %	473,742	2,362	2.00 %
NONINTEREST BEARING LIABILITIES:						
Demand deposits	125,539			113,808		
Other liabilities	7,514			6,686		

Total noninterest bearing liabilities		133,053					120,494				
TOTAL LIABILITIES		648,334					594,236				
Stockholders' equity		79,903					78,825				
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	728,237				$	673,061				
NET INTEREST INCOME AND MARGIN ON TOTAL EARNING ASSETS (4)			$	7,523	4.89 %			$	6,389	4.21 %	

(1) Interest on non-accrual loans is recognized into income on a cash received basis.
(2) Amounts of interest earned include loan fees of $237,000 and $322,000 for the quarters ended June 30, 2010 and 2009, respectively.
(3) Tax equivalent adjustments recorded at the statutory rate of 34% that are included in the nontaxable securities portfolio are $97,000 and $108,000 for the quarters ended June 30, 2010 and 2009, respectively. Tax equivalent adjustments included in the nontaxable securities portfolio were derived from nontaxable municipal interest income.
(4) The annualized net interest margin is computed by dividing net interest income by total average interest earning assets and multiplied by an annualization factor.

TABLE 2

NET INTEREST INCOME AND AVERAGE BALANCES
FNB BANCORP AND SUBSIDIARY

(Dollar amounts in thousands)	Six months ended June 30, 2010			2009		
	Average Balance	Interest	Annualized Average Yield	Average Balance	Interest	Annualized Average Yield
INTEREST EARNING ASSETS						
Loans, gross (1) (2)	$ 497,773	$ 15,936	6.46 %	$ 499,362	$ 15,818	6.39 %
Taxable securities (3)	84,252	941	2.25 %	52,850	970	3.70 %
Nontaxable securities (3)	30,641	714	4.70 %	39,285	927	4.76 %
Fed funds sold	—	—	n/a	12,894	60	0.94 %
Tot interest earning assets	612,666	17,591	5.79 %	604,391	17,775	5.93 %
NONINTEREST EARNING ASSETS:						
Cash and due from banks	68,590			19,850		
Premises	11,804			12,762		
Other assets	34,622			28,668		
Tot noninterest earning assets	115,016			61,280		
TOTAL ASSETS	$ 727,682			$ 665,671		
Demand, int bearing	$ 60,009	97	0.33 %	$ 57,911	156	0.54 %
Money market	269,549	1,679	1.26 %	163,029	1,709	2.11 %
Savings	42,704	53	0.25 %	43,655	64	0.30 %
Time deposits	124,254	834	1.35 %	137,523	1,458	2.14 %
FHLB advances	19,917	367	3.72 %	65,790	1,294	3.97 %
Fed funds purchased	6	—	n/a	3	—	n/a
Tot interest bearing liabilities	516,439	3,030	1.18 %	467,911	4,681	2.02 %
NONINTEREST BEARING LIABILITIES:						
Demand deposits	124,093			115,002		
Other liabilities	7,487			6,781		
Tot noninterest bearing liabilities	131,580			121,783		
TOTAL LIABILITIES	$ 648,019			$ 589,694		
Stockholders' equity	$ 79,663			$ 75,977		
	$ 727,682			$ 665,671		

TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY				
NET INTEREST INCOME AND MARGIN ON TOTAL EARNING ASSETS (4)	$ 14,561	4.79 %	$ 13,094	4.37 %

(1) Interest on non-accrual loans is recognized into income on a cash received basis.
(2) Amounts of interest earned included loan fees of $540,000 and $628,000 for the six months ended June 30, 2010 and 2009, respectively.
(3) Tax equivalent adjustments recorded at the statutory rate of 34% that are included in the nontaxable securities portfolio are $175,000 and $221,000 for the six months ended June 30, 2010 and 2009, respectively. Tax equivalent adjustments included in the nontaxable securities portfolio were derived from nontaxable municipal interest income.
(4) The annualized net interest margin is computed by dividing net interest income by total average interest earning assets and multiplied by an annualization factor.

Tables 1 and 2, above, show the various components that contributed to changes in net interest income for the three and six months ended June 30, 2010 and 2009. The principal interest earning assets are loans, from a volume as well as from a rate or yield perspective. For the quarter ended June 30, 2010, average loans outstanding represented 80.1% of average earning assets. For the quarter ended June 30, 2009, they represented 81.5% of average earning assets. For the six months ended June 30, 2010 and 2009, average loans outstanding represented 81.2% and 82.6%, respectively, of average earning assets.

The taxable equivalent yield on average interest earning assets for the quarter ended June 30, 2010 compared to the quarter ended June 30, 2009 decreased from 5.77% to 5.76%, or 1 basis point.Average loans decreased by $1,420,000, quarter to quarter, while their yield increased from 6.35% to 6.46%, or 11 basis points. Interest income on total interest earning assets increased $102,000 or 1.1% on a fully-taxable equivalent basis.

For the three months ended June 30, 2010 compared to the three months ended June 30, 2009, the cost on total interest bearing liabilities decreased from 2.00% to 1.04%, a decrease of 96 basis points. The most expensive source of interest bearing liabilities comes from Federal Home Loan Bank advances. Their average cost decreased from 4.38% to 2.86%, while their average balances outstanding decreased $43,022,000 and the expense on these advances decreased $526,000 for the three months ended June 30, 2010 compared to 2009. Time deposit interest cost decreased from 2.03% to 1.25%. Their average balance outstanding increased by $14,192,000, or 10.4%, while their expense decreased $309,000. Money market deposits average volume increased $96,255,000, or 54.3%, while their cost decreased 96 basis points, or 45.9%. The primary source of increase in money market funds is the Bank’s Money Market Maximizer account that pays a higher yield when customers utilize additional bank services. Interest rate reductions to the rates paid on Money Market accounts was the biggest contributor to the drop in interest expense during the second quarter of 2010.

For the six months ended June 30, 2010 compared to the six months ended June 30, 2009, interest income on interest earning assets decreased $184,000 or 1.0% on a fully-taxable equivalent basis, while average earning assets increased $8,275,000, or 1.4%. Average loans decreased by $1,589,000, or 0.3%. Interest on loans increased $118,000 or 0.7%, while yield increased 7 basis points, or 1.1%. The cost on total interest bearing liabilities decreased from 2.02% to 1.18%. Average Federal Home Loan Bank advances decreased $45,873,000 or 69.7%. Their yield decreased from 3.97% to 3.72%, and their cost decreased $927,000. Time deposit averages decreased $13,269,000 or 9.6%. Their yield decreased 79 basis points, or 36.9%. Money market deposit average balances increased $106,520,000, or 65.3%, but their cost decreased $30,000, or 1.7%. The Bank’s Money Market Maximizer account pays a variable rate of interest based on the number of qualifying bank products a customer owns. Most of the growth in the Money Market account was generated by the Money Market Maximizer account.

For the three and six month periods ended June 30, 2010 and June 30, 2009, respectively, the following tables show the dollar amount of change in interest income and expense and the dollar amounts attributable to: (a) changes in volume (changes in volume at the current year rate), and b) changes in rate (changes in rate times the prior year's volume). In this table, the dollar change in rate/volume is prorated to volume and rate proportionately.

Table 3

FNB BANCORP AND SUBSIDIARY
RATE/VOLUME VARIANCE ANALYSIS

(Dollar amounts in thousands)	Three Months Ended June 30, 2010 Compared to 2009		
	Interest Income/Expense	Variance Attributable to Rate	Variance Attributable to Volume
INTEREST EARNING ASSETS			
Loans	$113	$136	$(23)
Taxable securities	66	(142)	208
Nontaxable securities (1)	(67)	(5)	(62)
Federal funds sold	(10)	0	(10)
Total	$102	$(11)	$113
INTEREST BEARING LIABILITIES			
Demand deposits	$38	$42	$(4)
Money market	155	425	(270)
Savings deposits	4	4	0
Time deposits	309	237	72
Federal Home Loan Bank advances	526	57	469
Total	$1,032	$765	$267
NET INTEREST INCOME	$1,134	$754	$380

(1) Includes tax equivalent adjustment of $97,000 and $108,000 in the three months ended June 30, 2010 and June 30, 2009, respectively.

Table 4

FNB BANCORP AND SUBSIDIARY
RATE/VOLUME VARIANCE ANALYSIS

(Dollar amounts in thousands)	Six Months Ended June 30, 2010 Compared to 2009		
	Interest Income/Expense	Variance Attributable to Rate	Variance Attributable to Volume
INTEREST EARNING ASSETS			
Loans	$118	$168	$(50)
Taxable securities	(29)	(605)	576
Nontaxable securities (1)	(213)	(12)	(201)
Federal funds sold	(60)	—	(60)
Total	$(184)	$(449)	$265

INTEREST BEARING LIABILITIES			
Demand deposits	$59	$65	$(6)
Money market	30	1,146	(1,116)
Savings deposits	11	10	1
Time deposits	624	483	141
Federal Home Loan Bank advances	927	25	902
Federal funds purchased	—	—	—
Total	$1,651	$1,729	$(78)
NET INTEREST INCOME	$1,467	$1,280	$187

(1) Includes tax equivalent adjustment of $175,000 and $221,000 in the six months ended June 30, 2010 and June 30, 2009, respectively.

Noninterest income

The following table shows the principal components of noninterest income for the periods indicated.

Table 5
NONINTEREST INCOME

	Three months ended June 30,		Variance	
(Dollar amounts in thousands)	2010	2009	Amount	Percent
Service charges	$ 674	$ 699	$ (25)	-3.6 %
Credit card fees	162	173	(11)	-6.4 %
Gain on available-for-sale of securities	54	242	(188)	-77.7 %
Gain on sale of other real estate owned	1	—	1	—
Other income	135	131	4	3.1 %
Total noninterest income	$ 1,026	$ 1,245	$ (219)	-17.6 %

	Six months ended June 30,		Variance	
(Dollars in thousands)	2010	2009	Amount	Percent
Service charges	$ 1,359	$ 1,427	$ (68)	-4.8 %
Credit card fees	314	338	(24)	-7.1 %
Gain on sale of available-for-securities	162	246	(84)	-34.1 %
Gain on sale of other real estate owned	25	—	25	—
Other income	266	583	(317)	-54.4 %
Total noninterest income	$ 2,126	$ 2,594	$ (468)	-18.0 %

Noninterest income consists mainly of service charges on deposits, credit card fees and several other types of miscellaneous income.

Noninterest expense

The following table shows the principal components of noninterest expense for the periods indicated.

Table 6
NONINTEREST EXPENSE

	Three months ended June 30,		Variance	
(Dollar amounts in thousands)	2010	2009	Amount	Percent
Salaries and employee benefits	$ 3,478	$ 3,303	$ 175	5.3 %
Loss on impairment of other real estate owned	486	163	323	198.2 %
Occupancy expense	505	523	(18)	-3.4 %
Equipment expense	511	475	36	7.6 %
Professional fees	320	289	31	10.7 %
FDIC assessment	363	499	(136)	-27.3 %
Telephone, postage & supplies	267	259	8	3.1 %
Other real estate owned expense	414	383	31	8.1 %
Bankcard expenses	150	163	(13)	-8.0 %
Other expense	743	701	42	6.0 %
Total noninterest expense	$ 7,237	$ 6,758	$ 479	7.1 %

NONINTEREST EXPENSE

	Six months ended June 30,		Variance	
(Dollars in thousands)	2010	2009	Amount	Percent
Salaries and employee benefits	$ 6,980	$ 6,750	$ 230	3.4 %
Loss on impairment of other real estate owned	647	1,363	(716)	-52.5 %
Occupancy expense	1,017	1,035	(18)	-1.7 %
Equipment expense	1,023	957	66	6.9 %
Professional fees	579	625	(46)	-7.4 %
FDIC assessment	623	657	(34)	-5.2 %
Telephone, postage & supplies	545	532	13	2.4 %
Other real estate owned expense	612	504	108	21.4 %
Bankcard expenses	289	317	(28)	-8.8 %
Other expense	1,460	1,438	22	1.5 %
Total noninterest expense	$ 13,775	$ 14,178	$ (403)	-2.8 %

Noninterest expense consists mainly of salaries and employee benefits. For the three months ended June 30, 2010 compared to three months ended June 30, 2009, it represented 48.1% and 48.9% of total noninterest expenses. For the six months ended June 30, 2010 and 2009, it was 50.7% and 47.6% respectively of total noninterest expenses. During the first quarter of 2009, a $1,200,000 loss on impairment of other real estate owned was recorded that related to one land development foreclosure property. This property was written down in the first quarter based upon a new appraisal that reflected a significant valuation decline since the Company’s initial acquisition of the property. During 2010, the loss on impairment of other real estate owned was related to impairment charges on two parcels of land.

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Provision for Loan Losses.

There was a provision for loan losses of $565,000 and $2,900,000 for the six months ended June 30, 2010 and June 30, 2009, respectively. There was a provision of $315,000 and $760,000 for the three months ended June 30, 2010 and June 30, 2009, respectively. The allowance for loan losses was approximately $9,076,000 or 1.85% of total gross loans at June 30, 2010, compared to $9,829,000 or 1.95% of total gross loans at December 31, 2009. The allowance for loan losses is maintained at a level considered adequate for management to provide for probable loan losses inherent in the loan portfolio. The reduction in the provision for loan losses during the three and six months ended June 30, 2010 was related to decreasing classified loans compared to the same periods in 2009.

Income Taxes

The effective tax rate for the quarter ended June 30, 2010 was a 17.9% tax expense compared to a 50.0% tax expense for the quarter ended June 30, 2009. The effective tax rate for the six months ended June 30, 2010 and June 30, 2009, respectively was a tax expense of 19.8% compared to a tax benefit of 26.4%. Tax preference items which usually affect our effective tax rate are changing amounts invested in tax-advantaged securities, available Low Income Housing Credits, and amounts of interest income on qualifying loans in Enterprise Zones. Another significant cause of changes in the effective tax rate provision is the change in the relative proportion of tax advantaged income in comparison to fully taxable income period over period.

Asset and Liability Management

Ongoing management of the Company's interest rate sensitivity limits interest rate risk through monitoring the mix and maturity of loans, investments and deposits. Management regularly reviews the Company's position and evaluates alternative sources and uses of funds as well as changes in external factors. Various methods are used to achieve and maintain the desired rate sensitivity position including the sale or purchase of assets and product pricing.

In order to ensure that sufficient funds are available for loan growth and deposit withdrawals, as well as to provide for general needs, the Company must maintain an adequate level of liquidity. Asset liquidity comes from the Company's ability to convert short-term investments into cash and from the maturity and repayment of loans and investment securities. Liability liquidity comes from Company's customer base, which provides core deposit growth. The overall liquidity position of the Company is closely monitored and evaluated regularly. Management believes the Company's liquidity sources at June 30, 2010 are adequate to meet its operating needs in 2010 and our liquidity positions are sufficient to meet our liquidity needs in the near term.

Financial Condition

Assets. Total assets increased to $721,811,000 at June 30, 2010 from $708,309,000 at December 31, 2009, an increase of $13,502,000. The principal source of this increase was $28,788,000 in securities available-for-sale, partially offset by a decrease of $13,697,000 in net loans. Funding for the securities purchases was obtained from increased deposit inflows.

Loans. Gross loans at June 30, 2010 were $489,919,000, a decrease of $14,438,000 or 2.86% from December 31, 2009. Gross real estate loans increased $4,199,000, construction loans decreased $19,008,000, commercial loans increased $570,000 and consumer loans decreased by $199,000. The portfolio breakdown was as follows:

Table 7

LOAN PORTFOLIO

(Dollar amounts in thousands)	June 30, 2010	Percent	December 31, 2009	Percent
Real Estate	$ 390,729	79.8 %	$ 386,530	76.6 %
Construction	28,181	5.8 %	47,189	9.4 %
Commercial	68,547	14.0 %	67,977	13.5 %
Consumer	2,462	0.5 %	2,661	0.5 %
Gross loans	$ 489,919	100.0 %	$ 504,357	100.0 %
Net deferred loan (fees) cost	(191)		(179)	
Allowance for loan losses	(9,076)		(9,829)	
Net loans	$ 480,652		$ 494,349	

Allowance for loan losses. Management of the Company is responsible for assessing the overall risks within the Bank's loan portfolio, assessing the specific loss expectancy, and determining the adequacy of the allowance for loan losses. The level of the allowance is determined by internally generating credit quality ratings, historical loss experience, a review of economic conditions in the Company's market area, and a variety of general economic factors that could affect the amount of expected losses within the Bank's portfolio. The Company's management considers changes in national and local economic conditions, as well as the condition of various market segments. It also reviews any changes in the nature and volume of the portfolio. Management watches for the existence and effect of any concentrations of credit, and changes in the level of such concentrations. It also reviews the effect of external factors, such as competition and legal and regulatory requirements. Finally, the Company is committed to maintaining an adequate allowance, identifying credit weaknesses by consistent review of loans, and maintaining the ratings and changing those ratings in a timely manner as circumstances change.

A summary of activity in the allowance for loan losses for the six months ended June 30, 2010 and the six months ended June 30, 2009 is as follows.

TABLE 8

ALLOWANCE FOR LOAN LOSSES

	Six months ended	
(Dollar amounts in thousands)	6-30-2010	6-30-2009
Balance, beginning of period	$9,829	$7,075
Provision for loan losses	565	2,900
Recoveries	37	30
Amounts charged off	(1,355)	(910)
Balance, end of period	$9,076	$9,095

During the six months ended June 30, 2010, a provision for loan losses of $565,000 was recorded. During the first quarter of 2010, the Bank renegotiated the terms of a construction loan whereby the borrower agreed to make a $1,416,000 principal payment and the Bank charged off $1,003,000 for financial statement reporting purposes. Management continues to pursue collection activity on the whole relationship, and believes that ultimately all principal will be collected. During the six months ended June 30, 2009, a provision for loan losses of $2,900,000 was necessary due to increased expected losses within the Company's single family mortgage portfolio and a second

quarter increase of $14,530,000 in the volume of nonaccrual loans.

In management's judgment, the allowance was adequate to absorb losses currently inherent in the loan portfolio at June 30, 2010. However, changes in prevailing economic conditions in the Company's markets or in the financial condition of its customers could result in changes in the level of nonperforming assets and charge-offs in the future and, accordingly, changes in the allowance. The allowance is affected by a number of factors, and does not necessarily move in tandem with the level of gross loans outstanding. Management continues to monitor the factors that affect the allowance, and is prepared to make adjustments as they become necessary.

Nonperforming assets. Nonperforming assets consist of nonaccrual loans, loans that are 90 days or more past due but are still accruing interest and other real estate owned. At June 30, 2010, there was $22,775,000 in nonperforming assets, compared to $32,912,000 at December 31, 2009. Nonaccrual loans were $14,098,000 at June 30, 2010, compared to $25,592,000 at December 31, 2009. There was $8,677,000 in Other Real Estate Owned at June 30, 2010, and $7,320,000 at December 31, 2009. There were no loans past due 90 days and still accruing at either date. During the second quarter of 2010, the Bank obtained through foreclosure two properties with a fair market value of $2,218,000 that consisted of a single family residence in Redwood City and a parcel of land in Pacifica, CA. During the first quarter of 2010, the Bank obtained $965,000 in Other Real Estate Owned through the foreclosure process. During the first quarter of 2009, the Bank obtained title to two single family residences in San Anselmo, California that had a combined value of $3,298,000 at the time of foreclosure. One property was sold both in the first and second quarter of 2010, and there was one property sold in the fourth quarter of 2009. Management intends to aggressively market these properties. While management believes these properties will sell, there can be no assurance that these properties will sell quickly given the current real estate market, nor can the expected sales price be accurately predicted.

Deposits. Total deposits at June 30, 2010 were $620,166,000 compared to $598,964,000 on December 31, 2009. Of these totals, noninterest-bearing demand deposits were $125,455,000 or 20.2% of the total on June 30, 2010 and $120,515,000 or 20.1% on December 31, 2009. Time deposits were $120,169,000 on June 30, 2010 and $127,323,000 on December 31, 2009. During the first six months of 2010, compared to the same period in 2009, the deposit mix has changed to include a shift from demand and time deposits, which increased $1,347,000, to an increase in savings and money market deposits, which increased by $19,855,000. This shift is the result of some of our customers moving their funds into the Bank's highest yielding deposit product. This product pays a higher interest rate if the customer also has other deposit and loan products with the Bank.

The following table sets forth the maturity schedule of the time certificates of deposit on June 30, 2010:

TABLE 9

(Dollar amounts in thousands) Maturities	Under $ 100,000	$100,000 or more	Total
Three months or less	$14,439	$33,268	$47,707
Over three through six months	9,092	14,142	23,234
Over six through twelve months	12,306	21,839	34,145
Over twelve months	9,003	6,080	15,083
Total	$44,840	$75,329	$120,169

Federal Home Loan Bank advances. These advances declined by $10,000,000 or 40.0% at June 30, 2010 compared to December 31, 2009. The Bank has used some of the additional deposits raised to repay Federal Home Loan Bank advances during the six months ended June 30, 2010. To the extent additional deposit increases are realized during the remainder of 2010, additional advances will be repaid.

Regulatory Capital. The following table shows the risk-based capital ratios and leverage ratios at June 30, 2010 and December 31, 2009 for the Bank:

TABLE 10

Risk-Based Capital Ratios	June 30, 2010		December 31, 2009			Minimun “Well Capitalized” Requirements	
Total Risk-Based Capital Ratio	14.72	%	14.24	%	≥	10.00	%
Tier 1 Capital	13.47	%	12.99	%	≥	6.00	%
Leverage Ratios	10.61	%	10.73	%	≥	5.00	%

As a result of a regularly scheduled and recently concluded Office of the Comptroller of the Currency (“OCC”) examination, management and the Board of Directors have informally agreed with the OCC to take actions to further strengthen and improve asset quality and capital adequacy, including, among other things, to: maintain a minimum leverage capital ratio of 9% and total risk-based capital ratio of 12%; seek OCC approval and concurrence before declaring any dividends on common or preferred shares; to reduce the level of risk in the commercial real estate (“CRE”) segment of our loan portfolio; and strengthen the documentation of our analysis and review of the adequacy of our allowance for loan losses. As of December 31, 2010, the Bank is in compliance with the informal agreement with the OCC.

Liquidity. Liquidity is a measure of the Company’s ability to convert assets into cash with minimal loss. As of June 30, 2010, Liquid Assets were $186,852,000, or 25.9% of total assets. As of December 31, 2009, Liquid Assets were $160,041,000, or 22.6% of total assets. Liquidity consists of cash and due from banks, federal funds sold, and securities available-for-sale. The Company’s primary uses of funds are loans, and the primary sources of funds are deposits. The relationship between total net loans and total deposits is a useful additional measure of liquidity. The Company also has federal funds borrowing facilities totaling $45,000,000, a Federal Home Loan Bank line up to 30% of total assets, and a Federal Reserve Bank borrowing facility.

A higher loan to deposit ratio may lead to a loss of liquid assets in the future. This must be balanced against the fact that loans represent the highest interest earning assets. A lower loan to deposit ratio means lower potential income. On June 30, 2010, net loans were at 78% of deposits. On December 31, 2009, net loans were at 83% of deposits.

Off-Balance Sheet Items

The Company has certain ongoing commitments under operating leases. These commitments do not significantly impact operating results. As of June 30, 2010 and December 31, 2009, commitments to extend credit and letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. Loan commitments and letters of credit were $92,259,000 and $90,247,000 at June 30, 2010 and December 31, 2009, respectively. As a percentage of net loans, these off-balance sheet items represent 19.2% and 18.3% respectively.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market risk is the risk of loss to future earnings, to fair values of assets or to future cash flows that may result from changes in the price or value of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates and other market conditions. Market risk is attributed to all market risk sensitive financial instruments, including loans, investment securities, deposits and borrowings. The Company does not engage in trading activities or participate in foreign currency transactions for its own account. Accordingly, exposure to market risk is primarily a function of asset and liability management activities and of changes in market rates of interest. Changes in rates can cause or require increases in the rates paid on deposits that may take effect more rapidly or may be greater than the increases in the interest rates that the Company is able to charge on loans and the yields that it can realize on its investments. The extent of that market risk depends on a number of variables including the sensitivity to changes in market interest rates and the maturities of the Company's interest earning assets and deposits.

Item 4T. Controls and Procedures.

(a) Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and other members of the Company's senior management as of the end of the Company's fiscal quarter ended June 30, 2010. The Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as currently in effect are effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms.

(b) Internal Control Over Financial Reporting: An evaluation of any changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), that occurred during the Company's fiscal quarter ended June 30, 2010, was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and other members of the Company's senior management. The Company's Chief Executive Officer and Chief Financial Officer concluded that no change identified in connection with such evaluation has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

There are no material legal proceedings adverse to the Company or First National Bank to which any director, officer, affiliate of the Company, or 5% shareholder of the Company, or any associate of any such director, officer, affiliate or 5% shareholder of the Company are a party, and none of the foregoing persons has a material interest adverse to the Company or First National Bank.

From time to time, the Company and/or First National Bank are a party to claims and legal proceedings arising in the ordinary course of business. The Company's management is not aware of any material pending legal proceedings to which either it or First National Bank may be a party or has recently been a party, which will have a material adverse effect on the financial condition or results of operations of the Company and First National Bank, taken as a whole.

Item 1A. Risk Factors

There have been no material changes from risk factors previously disclosed by the Company in response to Item 1A, Part 1 of Form 10-K as of December 31, 2009.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

c) ISSUER PURCHASES OF EQUITY SECURITIES

On August 24, 2007, the Board of Directors of the Company authorized a stock repurchase program which calls for the repurchase of up to five percent (5%) of the Company's then outstanding 2,863,635 shares of Common Stock, or 143,182 shares. There were no repurchases during the quarter ended June 30, 2010. There were 10,457 shares remaining that may be purchased under this Plan as of June 30, 2010. Effective February 27, 2009, based on the Purchase Agreement with the U. S. Treasury, the Company may not repurchase Company common stock so long as the Treasury's Preferred Stock investment is outstanding.

Item 6. Exhibits

Exhibits

- 31: Rule 13a-14(a)/15d-14(a) Certifications
- 32: Section 1350 Certifications

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

FNB BANCORP
(Registrant)

Dated: August 13, 2010.

By: /s/ Thomas C. McGraw
Thomas C. McGraw
Chief Executive Officer
(Authorized Officer)

By: /s/ David A. Curtis
David A. Curtis
Senior Vice President
Chief Financial Officer
(Principal Financial Officer)