

FIRST NATIONAL CORP /VA/  
Form 10-Q  
May 13, 2008  
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**UNITED STATES**  
**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 March 31, 2008

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 Number: 0-23976

(Exact name of registrant as specified in its charter)

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|                                                                                              |                                                              |
|----------------------------------------------------------------------------------------------|--------------------------------------------------------------|
| <b>Virginia</b><br>(State or other jurisdiction of<br>incorporation or organization)         | <b>54-1232965</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>112 West King Street, Strasburg, Virginia</b><br>(Address of principal executive offices) | <b>22657</b><br>(Zip Code)                                   |
| <b>(540) 465-9121</b><br>(Registrant's telephone number, including area code)                |                                                              |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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 definitions of "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  (Do not check if smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of May 12, 2008, 2,922,860 shares of common stock, par value \$1.25 per share, of the registrant were outstanding.

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements  
FIRST NATIONAL CORPORATION****Consolidated Balance Sheets***(in thousands, except share and per share data)*

|                                                                                                                 | (unaudited)       |                      |
|-----------------------------------------------------------------------------------------------------------------|-------------------|----------------------|
|                                                                                                                 | March 31,<br>2008 | December 31,<br>2007 |
| <b>Assets</b>                                                                                                   |                   |                      |
| Cash and due from banks                                                                                         | \$ 8,950          | \$ 10,680            |
| Interest-bearing deposits in banks                                                                              | 2,063             | 2,229                |
| Securities available for sale, at fair value                                                                    | 57,017            | 57,503               |
| Loans held for sale                                                                                             | 678               | 270                  |
| Loans, net of allowance for loan losses, 2008, \$4,473, 2007, \$4,207                                           | 440,075           | 445,380              |
| Premises and equipment, net                                                                                     | 20,470            | 19,405               |
| Interest receivable                                                                                             | 2,271             | 2,227                |
| Other assets                                                                                                    | 4,011             | 3,871                |
| <b>Total assets</b>                                                                                             | <b>\$ 535,535</b> | <b>\$ 541,565</b>    |
| <b>Liabilities and Shareholders Equity</b>                                                                      |                   |                      |
| <b>Liabilities</b>                                                                                              |                   |                      |
| Deposits:                                                                                                       |                   |                      |
| Noninterest-bearing demand deposits                                                                             | \$ 83,637         | \$ 78,474            |
| Savings and interest-bearing demand deposits                                                                    | 172,970           | 177,676              |
| Time deposits                                                                                                   | 183,421           | 188,992              |
| <b>Total deposits</b>                                                                                           | <b>\$ 440,028</b> | <b>\$ 445,142</b>    |
| Federal funds purchased                                                                                         | 3,261             | 3,409                |
| Other borrowings                                                                                                | 40,532            | 40,564               |
| Company obligated mandatorily redeemable capital securities                                                     | 9,279             | 12,372               |
| Accrued expenses and other liabilities                                                                          | 3,060             | 2,219                |
| Commitments and contingencies                                                                                   |                   |                      |
| <b>Total liabilities</b>                                                                                        | <b>\$ 496,160</b> | <b>\$ 503,706</b>    |
| <b>Shareholders Equity</b>                                                                                      |                   |                      |
| Common stock, par value \$1.25 per share; authorized 8,000,000 shares; issued and outstanding, 2,922,860 shares | \$ 3,653          | \$ 3,653             |
| Surplus                                                                                                         | 1,453             | 1,453                |
| Retained earnings                                                                                               | 34,319            | 33,311               |
| Unearned ESOP shares                                                                                            | (352)             | (379)                |

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|                                                  |            |            |
|--------------------------------------------------|------------|------------|
| Accumulated other comprehensive gain (loss), net | 302        | (179)      |
| Total shareholders' equity                       | \$ 39,375  | \$ 37,859  |
| Total liabilities and shareholders' equity       | \$ 535,535 | \$ 541,565 |

*See Notes to Consolidated Financial Statements*

**Table of Contents****FIRST NATIONAL CORPORATION****Consolidated Statements of Income**

Three months ended March 31, 2008 and 2007

*(in thousands, except per share data)*

|                                                                         | (unaudited)<br>March 31,<br>2008 | (unaudited)<br>March 31,<br>2007 |
|-------------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>Interest and Dividend Income</b>                                     |                                  |                                  |
| Interest and fees on loans                                              | \$ 7,718                         | \$ 7,953                         |
| Interest on federal funds sold                                          | 6                                | 14                               |
| Interest on deposits in banks                                           | 18                               | 25                               |
| Interest and dividends on securities available for sale:                |                                  |                                  |
| Taxable interest                                                        | 515                              | 535                              |
| Tax-exempt interest                                                     | 133                              | 115                              |
| Dividends                                                               | 50                               | 47                               |
| <b>Total interest and dividend income</b>                               | <b>\$ 8,440</b>                  | <b>\$ 8,689</b>                  |
| <b>Interest Expense</b>                                                 |                                  |                                  |
| Interest on deposits                                                    | \$ 3,033                         | \$ 3,542                         |
| Interest on federal funds purchased                                     | 19                               | 39                               |
| Interest on company obligated mandatorily redeemable capital securities | 223                              | 236                              |
| Interest on other borrowings                                            | 513                              | 550                              |
| <b>Total interest expense</b>                                           | <b>\$ 3,788</b>                  | <b>\$ 4,367</b>                  |
| Net interest income                                                     | \$ 4,652                         | \$ 4,322                         |
| Provision for loan losses                                               | 270                              |                                  |
| Net interest income after provision for loan losses                     | \$ 4,382                         | \$ 4,322                         |
| <b>Noninterest Income</b>                                               |                                  |                                  |
| Service charges                                                         | \$ 698                           | \$ 619                           |
| Fees for other customer services                                        | 436                              | 351                              |
| Trust and asset management fees                                         | 231                              | 225                              |
| Gains on sale of loans                                                  | 37                               | 73                               |
| Other operating income                                                  | 98                               | 22                               |
| <b>Total noninterest income</b>                                         | <b>\$ 1,500</b>                  | <b>\$ 1,290</b>                  |
| <b>Noninterest Expense</b>                                              |                                  |                                  |
| Salaries and employee benefits                                          | \$ 2,103                         | \$ 1,866                         |
| Occupancy                                                               | 250                              | 246                              |
| Equipment                                                               | 347                              | 318                              |

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|                                                     |                 |                 |
|-----------------------------------------------------|-----------------|-----------------|
| Marketing                                           | 106             | 128             |
| Stationery and supplies                             | 111             | 107             |
| Legal and professional fees                         | 173             | 168             |
| ATM and check card                                  | 147             | 118             |
| Other operating expense                             | 580             | 588             |
| <b>Total noninterest expense</b>                    | <b>\$ 3,817</b> | <b>\$ 3,539</b> |
| Income before income taxes                          | \$ 2,065        | \$ 2,073        |
| Provision for income taxes                          | 650             | 670             |
| <b>Net income</b>                                   | <b>\$ 1,415</b> | <b>\$ 1,403</b> |
| <b>Earnings per common share, basic and diluted</b> | <b>\$ 0.49</b>  | <b>\$ 0.48</b>  |

*See Notes to Consolidated Financial Statements*

**Table of Contents****FIRST NATIONAL CORPORATION****Consolidated Statements of Cash Flows**

Three months ended March 31, 2008 and 2007

*(in thousands)*

|                                                                                                    | (unaudited)<br>March 31,<br>2008 | (unaudited)<br>March 31,<br>2007 |
|----------------------------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>Cash Flows from Operating Activities</b>                                                        |                                  |                                  |
| Net income                                                                                         | \$ 1,415                         | \$ 1,403                         |
| Adjustments to reconcile net income to cash and cash equivalents provided by operating activities: |                                  |                                  |
| Depreciation and amortization                                                                      | 288                              | 278                              |
| Provision for loan losses                                                                          | 270                              |                                  |
| Origination of loans held for sale                                                                 | (3,947)                          | (5,987)                          |
| Proceeds from sale of loans available for sale                                                     | 3,576                            | 6,061                            |
| Gains on sale of loans                                                                             | (37)                             | (73)                             |
| Accretion of security discounts                                                                    | (13)                             | (9)                              |
| Amortization of security premiums                                                                  | 23                               | 28                               |
| Shares acquired by leveraged ESOP                                                                  | 27                               | 24                               |
| Changes in assets and liabilities:                                                                 |                                  |                                  |
| (Increase) decrease in interest receivable                                                         | (44)                             | 47                               |
| (Increase) decrease in other assets                                                                | (139)                            | 14                               |
| Increase in accrued expenses and other liabilities                                                 | 592                              | 419                              |
| Net cash provided by operating activities                                                          | \$ 2,011                         | \$ 2,205                         |
| <b>Cash Flows from Investing Activities</b>                                                        |                                  |                                  |
| Proceeds from sales of securities available for sale                                               | \$ 180                           | \$ 652                           |
| Proceeds from maturities, calls, and principal payments of securities available for sale           | 2,143                            | 1,886                            |
| Purchase of securities available for sale                                                          | (1,118)                          | (3,205)                          |
| Decrease in federal funds sold                                                                     |                                  | 4,159                            |
| Purchase of premises and equipment                                                                 | (1,353)                          | (984)                            |
| Net (increase) decrease in loans                                                                   | 5,035                            | (1,411)                          |
| Net cash provided by investing activities                                                          | \$ 4,887                         | \$ 1,097                         |
| <b>Cash Flows from Financing Activities</b>                                                        |                                  |                                  |
| Net increase in demand deposits and savings accounts                                               | \$ 457                           | \$ 14,259                        |
| Net (decrease) in time deposits                                                                    | (5,571)                          | (14,487)                         |
| Proceeds from other borrowings                                                                     | 10,000                           | 74,500                           |
| Principal payments on other borrowings                                                             | (10,032)                         | (79,529)                         |
| Principal payments on company obligated mandatorily redeemable capital securities                  | (3,093)                          |                                  |
| Cash dividends paid                                                                                | (407)                            | (377)                            |
| Decrease in federal funds purchased                                                                | (148)                            |                                  |
| Net cash used in financing activities                                                              | \$ (8,794)                       | \$ (5,634)                       |
| Decrease in cash and cash equivalents                                                              | \$ (1,896)                       | \$ (2,332)                       |
| <b>Cash and Cash Equivalents</b>                                                                   |                                  |                                  |
| Beginning                                                                                          | 12,909                           | 12,127                           |



|        |           |          |
|--------|-----------|----------|
| Ending | \$ 11,013 | \$ 9,795 |
|--------|-----------|----------|

*See Notes to Consolidated Financial Statements*

**Table of Contents****FIRST NATIONAL CORPORATION****Consolidated Statements of Cash Flows**

(Continued)

Three months ended March 31, 2008 and 2007

*(in thousands)*

|                                                                 | <b>(unaudited)</b><br><b>March 31,</b><br><b>2008</b> | <b>(unaudited)</b><br><b>March 31,</b><br><b>2007</b> |
|-----------------------------------------------------------------|-------------------------------------------------------|-------------------------------------------------------|
| <b>Supplemental Disclosures of Cash Flow Information</b>        |                                                       |                                                       |
| Cash payments for:                                              |                                                       |                                                       |
| Interest                                                        | \$ 3,874                                              | \$ 4,469                                              |
| Income taxes                                                    | \$ 934                                                | \$                                                    |
| <b>Supplemental Disclosures of Noncash Investing Activities</b> |                                                       |                                                       |
| Unrealized gain on securities available for sale                | \$ 728                                                | \$ 95                                                 |

*See Notes to Consolidated Financial Statements*

**Table of Contents****FIRST NATIONAL CORPORATION****Consolidated Statements of Changes in Shareholders' Equity**

Three months ended March 31, 2008 and 2007

*(in thousands, except share and per share data)**(unaudited)*

|                                                                       | Common<br>Stock | Surplus  | Retained<br>Earnings | Unearned<br>ESOP<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Comprehensive<br>Income | Total     |
|-----------------------------------------------------------------------|-----------------|----------|----------------------|----------------------------|-----------------------------------------------------------|-------------------------|-----------|
| <b>Balance, December 31, 2006</b>                                     | \$ 3,653        | \$ 1,465 | \$ 29,104            | \$ (546)                   | \$ (1,121)                                                |                         | \$ 32,555 |
| Comprehensive income:                                                 |                 |          |                      |                            |                                                           |                         |           |
| Net income                                                            |                 |          | 1,403                |                            |                                                           | \$ 1,403                | 1,403     |
| Other comprehensive income, net of tax:                               |                 |          |                      |                            |                                                           |                         |           |
| Unrealized holding gains arising during the period (net of tax, \$32) |                 |          |                      |                            |                                                           |                         |           |