

FIRST COMMUNITY BANCSHARES INC /NV/

Form 10-Q

August 08, 2007

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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 quarter ended June 30, 2007
Commission file number 000-19297
FIRST COMMUNITY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)**

Nevada

55-0694814

(State or other jurisdiction of
incorporation)

(IRS Employer Identification No.)

**P.O. Box 989
Bluefield, Virginia**

24605-0989

(Address of principal executive offices)

(Zip Code)

(276) 326-9000

(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 the 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class Common Stock, \$1.00 Par Value; 11,207,262 shares outstanding as of July 31, 2007

FIRST COMMUNITY BANCSHARES, INC.
FORM 10-Q
For the quarter ended June 30, 2007
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CONSOLIDATED BALANCE SHEETS**

	June 30, 2007 (Unaudited)	December 31, 2006
<i>(Dollars in Thousands, Except Share and Per Share Data)</i>		
Assets		
Cash and due from banks	\$ 40,879	\$ 47,909
Interest-bearing balances with banks	33,380	9,850
Total cash and cash equivalents	74,259	57,759
Securities available-for-sale (amortized cost of \$666,701 at June 30, 2007; \$508,423 at December 31, 2006)	658,901	508,370
Securities held-to-maturity (fair value of \$13,389 at June 30, 2007; \$20,350 at December 31, 2006)	13,177	20,019
Loans held for sale	1,818	781
Loans held for investment, net of unearned income	1,243,076	1,284,863
Less allowance for loan losses	13,934	14,549
Net loans held for investment	1,229,142	1,270,314
Premises and equipment	42,274	36,889
Other real estate owned	593	258
Interest receivable	12,892	12,141
Goodwill and other intangible assets	62,017	62,196
Other assets	73,522	64,971
Total Assets	\$ 2,168,595	\$ 2,033,698
Liabilities		
Deposits:		
Noninterest-bearing	\$ 241,423	\$ 244,771
Interest-bearing	1,180,537	1,150,000
Total Deposits	1,421,960	1,394,771
Interest, taxes and other liabilities	21,000	19,641
Federal funds purchased		7,700
Securities sold under agreements to repurchase	217,987	201,185
FHLB borrowings and other indebtedness	291,387	197,671
Total Liabilities	1,952,334	1,820,968
Stockholders Equity		
Preferred stock, par value undesignated; 1,000,000 shares authorized; none issued	11,499	11,499

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Common stock, \$1 par value; 25,000,000 shares authorized; 11,499,018 shares issued at June 30, 2007, and December 31, 2006, including 266,552 and 253,276 shares in treasury, respectively

Additional paid-in capital	108,633	108,806
Retained earnings	108,601	100,117
Treasury stock, at cost	(8,341)	(7,924)
Accumulated other comprehensive (loss) income	(4,131)	232
Total Stockholders' Equity	216,261	212,730
Total Liabilities and Stockholders' Equity	\$ 2,168,595	\$ 2,033,698

See Notes to Consolidated Financial Statements.

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FIRST COMMUNITY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

<i>(Dollars in Thousands, Except Share and Per Share Data)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Interest Income				
Interest and fees on loans held for investment	\$ 23,404	\$ 24,506	\$ 46,923	\$ 48,431
Interest on securities-taxable	6,030	3,224	11,011	6,101
Interest on securities-nontaxable	2,150	1,816	4,062	3,642
Interest on deposits in banks	395	479	669	774
Total interest income	31,979	30,025	62,665	58,948
Interest Expense				
Interest on deposits	9,748	8,326	19,048	15,973
Interest on borrowings	5,217	3,526	9,588	6,737
Total interest expense	14,965	11,852	28,636	22,710
Net interest income	17,014	18,173	34,029	36,238
Provision for loan losses		811		1,219
Net interest income after provision for loan losses	17,014	17,362	34,029	35,019
Noninterest Income				
Wealth management income	1,005	732	2,023	1,415
Service charges on deposit accounts	2,662	2,655	5,071	5,072
Other service charges, commissions and fees	837	711	1,707	1,451
Gain (loss) on sale of securities	30	(94)	159	66
Other operating income	1,013	1,516	1,802	2,664
Total noninterest income	5,547	5,520	10,762	10,668
Noninterest Expense				
Salaries and employee benefits	6,165	6,782	12,576	14,683
Occupancy expense of bank premises	1,020	1,011	2,077	2,051
Furniture and equipment expense	780	858	1,603	1,708
Intangible amortization	105	144	208	234
Other operating expense	4,005	3,793	7,769	7,245
Total noninterest expense	12,075	12,588	24,233	25,921
Income before income taxes	10,486	10,294	20,558	19,766
Income tax expense	3,047	3,002	5,995	5,630
Net income	\$ 7,439	\$ 7,292	\$ 14,563	\$ 14,136
Basic earnings per common share	\$ 0.66	\$ 0.65	\$ 1.29	\$ 1.26

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Diluted earnings per common share	\$	0.66	\$	0.65	\$	1.28	\$	1.25
Dividends declared per common share	\$	0.27	\$	0.26	\$	0.54	\$	0.52
Weighted average basic shares outstanding		11,260,868		11,201,052		11,260,126		11,216,940
Weighted average diluted shares outstanding		11,320,227		11,258,581		11,334,486		11,277,032

See Notes to Consolidated Financial Statements.

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FIRST COMMUNITY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

<i>(In Thousands)</i>	Six Months Ended June 30,	
	2007	2006
Operating activities:		
Net Income	\$ 14,563	\$ 14,136
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses		1,219
Depreciation and amortization of premises and equipment	1,585	1,709
Intangible amortization	208	234
Net investment amortization and accretion	282	303
Net gain on the sale of assets	(154)	(785)
Mortgage loans originated for sale	(23,737)	(13,332)
Proceeds from sales of mortgage loans	22,831	13,372
Gain on sales of loans	(131)	(59)
Deferred income tax (benefit) expense	(164)	60
(Increase) decrease in interest receivable	(751)	43
Other operating activities, net	(3,494)	1,197
 Net cash provided by operating activities	 11,038	 18,097
 Investing activities:		
Proceeds from sales of securities available-for-sale	827	1,824
Proceeds from maturities and calls of securities available-for-sale	16,784	12,807
Proceeds from maturities and calls of securities held-to-maturity	6,809	3,574
Purchase of securities available-for-sale	(175,977)	(20,379)
Net decrease in loans held for investment	40,832	9,514
Purchase of bank-owned life insurance		(25,000)
Net cash used in branch divestiture		(13,721)
Purchase of premises and equipment	(6,977)	(3,237)
Proceeds from sale of equipment		298
 Net cash used in investing activities	 (117,702)	 (34,320)
 Financing activities:		
Net increase in demand and savings deposits	15,331	13,344
Net increase in time deposits	11,858	10,141
Net decrease in federal funds purchased	(7,700)	(82,500)
Net increase in securities sold under agreement to repurchase	16,802	25,632
Net increase in FHLB and other borrowings	93,716	74,927
Proceeds from the exercise of stock options	681	322
Excess tax benefit from stock-based compensation	284	105
Acquisition of treasury stock	(1,729)	(4,125)
Dividends paid	(6,079)	(5,828)

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Net cash provided by financing activities	123,164	32,018
Increase in cash and cash equivalents	16,500	15,795
Cash and cash equivalents at beginning of period	57,759	57,539
Cash and cash equivalents at end of period	\$ 74,259	\$ 73,334
Supplemental information Noncash items		
Transfer of loans to other real estate	\$ 853	\$ 490

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FIRST COMMUNITY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (Unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
<i>(Dollars in Thousands, Except Share Data)</i>						
Balance January 1, 2006	\$ 11,496	\$ 108,573	\$ 82,828	\$ (7,625)	\$ (771)	\$ 194,501
Comprehensive income:						
Net income			14,136			14,136
Other comprehensive income, net of tax:						
Unrealized loss on securities available for sale					(3,352)	(3,352)
Less reclassification adjustment for gains realized in net income					(16)	(16)
Unrealized gain on derivative security					902	902
Comprehensive income			14,136		(2,466)	11,670
Common dividends declared			(5,828)			(5,828)
Net acquisition of 130,861 treasury shares				(4,125)		(4,125)
Acquisition of Stone Capital 2,706 shares issued	3	85				88
Stock awards 5,132 shares issued		(36)		160		124
ESOP allocation 27,733 shares		16		867		883
Equity-based compensation expense		140				140
Tax benefit from exercise of stock options		139				139
Option exercise 19,942 shares		(315)		626		311
Balance June 30, 2006	\$ 11,499	\$ 108,602	\$ 91,136	\$ (10,097)	\$ (3,237)	\$ 197,903
Balance January 1, 2007	\$ 11,499	\$ 108,806	\$ 100,117	\$ (7,924)	\$ 232	\$ 212,730
Comprehensive income:						
Net income			14,563			14,563
Other comprehensive income, net of tax:						
Unrealized loss on securities available-for-sale					(4,601)	(4,601)
Less reclassification adjustment for gains realized in net income					(47)	(47)
Unrealized gain on derivative security					285	285
Comprehensive income			14,563		(4,363)	10,200
Common dividends declared			(6,079)			(6,079)
Acquisition of 55,200 treasury shares				(1,729)		(1,729)
Equity-based compensation expense		66		87		153

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Tax benefit from exercise stock options	328					328
Option exercises 39,174 shares	(567)			1,225		658
Balance June 30, 2007	\$ 11,499	\$ 108,633	\$ 108,601	\$ (8,341)	\$ (4,131)	\$ 216,261

See Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. General

Unaudited Consolidated Financial Statements

The accompanying unaudited condensed consolidated financial statements of First Community Bancshares, Inc. and subsidiaries (First Community or the Company) have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments including normal recurring accruals, necessary for a fair presentation, have been made. These results are not necessarily indicative of the results of consolidated operations that might be expected for the full calendar year.

The consolidated balance sheet as of December 31, 2006, has been derived from the audited financial statements included in the Company s 2006 Annual Report on Form 10-K. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted in accordance with standards for the preparation of interim consolidated financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2006 Annual Report on Form 10-K. A more complete and detailed description of First Community s significant accounting policies is included within Footnote 1 to the Company s Annual Report on Form 10-K for December 31, 2006. Further discussion of the Company s application of critical accounting policies is included within the Application of Critical Accounting Policies section of Part I, Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, included herein.

The Company operates within one business segment, community banking.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, which seeks to reduce the diversity in practice associated with the accounting and reporting for uncertainty in income tax positions. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The Company adopted FIN 48 on January 1, 2007, and the adoption did not have an effect on its consolidated financial statements. The Company includes interest and penalties related to income tax liabilities in income tax expense. The Company and its subsidiaries tax filings for the years ended December 31, 2003 through 2006 are currently open to audit under statutes of limitation by the Internal Revenue Service and various state tax departments.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140. SFAS 156 requires that all separately recognized servicing assets and liabilities be initially measured at fair value and permits (but does not require) subsequent measurement of servicing assets and liabilities at fair value. This statement is effective for fiscal years beginning after September 15, 2006. The adoption of this standard did not have a material effect on the financial condition, the results of operations, or liquidity of the Company.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. The Company must adopt these new requirements no later than the first quarter of 2008. The Company has not yet determined the effect of adopting SFAS 157 on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 123(R). SFAS 158 requires an employer to: (a) recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status; (b) measure a plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive

income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the

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fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company does not expect the full adoption of this standard to have a significant impact on its consolidated financial statements.

In September 2006, the Emerging Issues Task Force reached a consensus regarding EITF 06-4 Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. The scope of EITF 06-4 is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. Therefore, this EITF would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer. EITF 06-4 is effective for fiscal years beginning after December 15, 2007, with earlier application permitted. The Company does not expect the adoption of this EITF to have a significant impact on its consolidated financial statements.

In September 2006, the Emerging Issues Task Force reached a consensus regarding EITF 06-5 Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4. The scope of EITF 06-5 is limited to the determination of net cash surrender value of a life insurance contract in accordance with Technical Bulletin 85-4. This EITF outlines when contractual limitations of the policy should be considered when determining the net realizable value of the contract. EITF 06-5 is effective for fiscal years beginning after December 15, 2006, with earlier application permitted. The adoption of EITF 06-5 did not have a material effect on the condition, results of operations, or liquidity of the Company.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The Statement's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of Statement 157. The Company did not elect early adoption as provided for in the Statement, and is currently evaluating the impact, if any, of adopting this Statement on the consolidated financial statements.

Note 2. Mergers, Acquisitions and Branching Activity

In March 2007, the Company opened two new branch locations in the Winston-Salem, North Carolina, area. The Company currently has plans to open five more branch offices during 2007. In Richmond, Virginia, locations are planned for the Chesterfield Towne Center and on Mechanicsville Turnpike, Route 360. In West Virginia, locations are planned for Daniels, Summersville, and Princeton. These locations are all in various stages of construction, and are anticipated to be open by the third and fourth quarters of 2007.

In December 2006, the Company completed the sale of its Rowlesburg, West Virginia, branch location. At the time of the sale, the branch had deposits and repurchase agreements totaling approximately \$10.6 million and loans of approximately \$2.2 million. The transaction resulted in a pre-tax gain of approximately \$333 thousand.

In November 2006, the Company completed the acquisition of Investment Planning Consultants, Inc. (IPC), a registered investment advisory firm. In connection with the initial payment of approximately \$1.47 million, the Company issued 39,874 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of IPC are entitled to additional consideration aggregating up to \$1.43 million in the form of the Company's common stock, valued at the time of issuance, if certain future operating performance targets are met. If those operating targets are met, the value of the consideration ultimately paid will be added to the cost of the acquisition, which will increase the amount of goodwill related to the acquisition.

In June 2006, the Company sold its Drakes Branch, Virginia, location. At the time of the sale, the branch had deposits and repurchase agreements totaling approximately \$16.4 million and loans of approximately \$1.9 million. The transaction resulted in a pre-tax gain of approximately \$702 thousand.

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As of June 30, 2007, and December 31, 2006, the amortized cost and estimated fair value of available-for-sale securities are as follows:

	June 30, 2007			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
<i>(In Thousands)</i>				
U.S. Government agency securities	\$ 136,784	\$	\$ (2,885)	\$ 133,899
States and political subdivisions	188,303	1,220	(3,909)	185,614
Corporate notes	145,023	393	(430)	144,986
Mortgage-backed securities	188,391	138	(4,129)	184,400
Equities	8,200	1,940	(138)	10,002
Total	\$ 666,701	\$ 3,691	\$ (11,491)	\$ 658,901

	December 31, 2006			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. Government agency securities	\$ 117,777	\$	\$ (1,716)	\$ 116,061
States and political subdivisions	152,189	2,379	(521)	154,047
Corporate notes	85,080	350	(397)	85,033
Mortgage-backed securities	146,444	206	(1,896)	144,754
Equities	6,933	1,615	(73)	8,475
Total	\$ 508,423	\$ 4,550	\$ (4,603)	\$ 508,370

As of June 30, 2007, and December 31, 2006, the amortized cost and estimated fair value of held-to-maturity securities are as follows:

	June 30, 2007			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
<i>(In Thousands)</i>				
States and political subdivisions	\$ 12,799	\$ 219	\$ (7)	\$ 13,011
Mortgage-backed securities	3			3
Other securities	375			375
Total	\$ 13,177	\$ 219	\$ (7)	\$ 13,389

	December 31, 2006			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
States and political subdivisions	\$ 19,638	\$ 334	\$ (2)	\$ 19,970
Mortgage-backed securities	6			6
Other securities	375		(1)	374

Total	\$ 20,019	\$ 334	\$ (3)	\$ 20,350
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The following table reflects those investments in an unrealized loss position at June 30, 2007, and December 31, 2006. There were no securities in a continuous unrealized loss position for 12 or more months which the Company does not have the ability to hold until the security matures or recovers in value.

Description of Securities	June 30, 2007					
	Less than 12 Months		12 Months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(In Thousands)</i>						
U. S. Government agency securities	\$ 79,440	\$ (1,493)	\$ 54,459	\$ (1,392)	\$ 133,899	\$ (2,885)
States and political subdivisions	86,000	(2,792)	33,968	(1,124)	119,968	(3,916)
Other securities	62,662	(430)			62,662	(430)
Mortgage-backed securities	115,870	(2,359)	53,028	(1,770)	168,898	(4,129)
Equity securities	1,144	(58)	1,665	(80)	2,809	(138)
Total	\$ 345,116	\$ (7,132)	\$ 143,120	\$ (4,366)	\$ 488,236	\$ (11,498)

Description of Securities	December 31, 2006					
	Less than 12 Months		12 Months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U. S. Government agency securities	\$ 60,416	\$ (517)	\$ 55,645	\$ (1,199)	\$ 116,061	\$ (1,716)
States and political subdivisions	10,732	(34)	36,797	(489)	47,529	(523)
Other securities	28,339	(213)	27,698	(185)	56,037	(398)
Mortgage-backed securities	50,093	(223)	66,620	(1,673)	116,713	(1,896)
Equity securities	2,186	(70)	32	(3)	2,218	(73)
Total	\$ 151,766	\$ (1,057)	\$ 186,792	\$ (3,549)	\$ 338,558	\$ (4,606)

At June 30, 2007, the combined depreciation in value of the 351 individual security holdings in an unrealized loss position was 1.71% of the combined reported value of the aggregate securities portfolio. Management does not believe any individual unrealized loss as of June 30, 2007, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes the declines in value are attributable to changes in market interest rates and not the credit quality of the issuer.

Note 4. Loans

Loans, net of unearned income, consist of the following:

	June 30, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
<i>(Dollars in Thousands)</i>				
Loans held for investment:				
Commercial and agricultural	\$ 96,835	7.79%	\$ 106,645	8.30%
Commercial real estate	394,418	31.73%	421,067	32.77%
Residential real estate	498,156	40.07%	506,370	39.41%

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Construction	166,010	13.35%	158,566	12.34%
Consumer	83,665	6.73%	88,666	6.90%
Other	3,992	0.33%	3,549	0.28%
Total	\$ 1,243,076	100.00%	\$ 1,284,863	100.00%

Loans held for sale	\$ 1,818	\$ 781
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The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the

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amount recognized on the balance sheet. The contractual amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on management's credit evaluation of the counterparties. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit and written financial guarantees are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. To the extent deemed necessary, collateral of varying types and amounts is held to secure customer performance under certain of those letters of credit outstanding.

Financial instruments whose contract amounts represent credit risk at June 30, 2007, are commitments to extend credit (including availability of lines of credit) of \$224.31 million and standby letters of credit and financial guarantees written of \$4.70 million.

Note 5. Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient to absorb probable loan losses inherent in the loan portfolio. The allowance is increased by charges to earnings in the form of provision for loan losses and recoveries of prior loan charge-offs, and decreased by loans charged off. The provision is calculated to bring the allowance to a level which, according to a systematic process of measurement, reflects the amount management estimates is needed to absorb probable losses within the portfolio.

Management performs periodic assessments to determine the appropriate level of allowance. Differences between actual loan loss experience and estimates are reflected through adjustments that are made by either increasing or decreasing the loss provision based upon current measurement criteria. Commercial, consumer and mortgage loan portfolios are evaluated separately for purposes of determining the allowance. The specific components of the allowance include allocations to individual commercial credits and allocations to the remaining non-homogeneous and homogeneous pools of loans. Management's allocations are based on judgment of qualitative and quantitative factors about both macro and micro economic conditions reflected within the portfolio of loans and the economy as a whole. Factors considered in this evaluation include, but are not necessarily limited to, probable losses from loan and other credit arrangements, general economic conditions, changes in credit concentrations or pledged collateral, historical loan loss experience, and trends in portfolio volume, maturities, composition, delinquencies, and non-accruals. While management has allocated the allowance for loan losses to various portfolio segments, the entire allowance is available for use against any type of loan loss deemed appropriate by management.

The following table details the Company's allowance for loan loss activity for the three- and six-month periods ended June 30, 2007 and 2006.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
<i>(In Thousands)</i>				
Beginning balance	\$ 14,510	\$ 14,797	\$ 14,549	\$ 14,736

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Provision for loan losses		811		1,219
Charge-offs	(911)	(1,389)	(1,804)	(2,104)
Recoveries	335	491	1,189	859
Ending balance	\$ 13,934	\$ 14,710	\$ 13,934	\$ 14,710

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Table of Contents**Note 6. Deposits**

The following is a summary of interest-bearing deposits by type as of June 30, 2007, and December 31, 2006.

	June 30, 2007	December 31, 2006
<i>(In Thousands)</i>		
Interest-bearing demand deposits	\$ 143,080	\$ 140,578
Savings deposits	333,855	317,678
Certificates of deposit	703,602	691,744
Total	\$ 1,180,537	\$ 1,150,000

Note 7. Borrowings

The following schedule details the Company's Federal Home Loan Bank (FHLB) borrowings and other indebtedness at June 30, 2007, and December 31, 2006.

	June 30, 2007	December 31, 2006
<i>(In thousands)</i>		
FHLB borrowings	\$ 275,923	\$ 182,207
Subordinated debt	15,464	15,464
Total	\$ 291,387	\$ 197,671

FHLB borrowings include \$275.00 million in convertible and callable advances and \$923 thousand of noncallable term advances from the FHLB at June 30, 2007. The weighted average interest rates of advances are 4.46% and 4.64% at June 30, 2007, and December 31, 2006, respectively.

The Company has entered into a derivative interest rate swap instrument where it receives LIBOR-based variable interest payments and pays fixed interest payments. The notional amount of the derivative swap is \$50 million and effectively fixes a portion of the FHLB borrowings at approximately 4.34%. After considering the effect of the interest rate swap, the effective weighted average interest rate of all FHLB borrowings is 4.35% at June 30, 2007. The fair value of the interest rate swap was \$915 thousand at June 30, 2007.

At June 30, 2007, the FHLB advances have maturities between three and fourteen years. The scheduled maturities of the advances are as follows:

	Amount
<i>(In Thousands)</i>	
2007	\$
2008	
2009	
2010	25,000
2011	
2012 and thereafter	250,923
Total	\$ 275,923

The callable advances may be redeemed at quarterly intervals after various lockout periods. These call options may substantially shorten the lives of these instruments. If these advances are called, the debt may be paid in full, converted to another FHLB credit product, or converted to a fixed or adjustable rate advance. Prepayment of the advances may result in substantial penalties based upon the differential between contractual note rates and current advance rates for similar maturities. Advances from the FHLB are secured by stock in the FHLB of Atlanta, qualifying first mortgage loans, mortgage-backed securities, and certain other securities.

Also included in borrowings is \$15.5 million of junior subordinated debentures (the Debentures) issued by the Company in October 2003 to an unconsolidated trust subsidiary, FCBI Capital Trust (the Trust) with an interest rate of three-month

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LIBOR plus 2.95%. The Trust was able to purchase the Debentures through the issuance of trust preferred securities which had substantially identical terms as the Debentures. The Debentures mature on October 8, 2033, and are callable beginning October 8, 2008. The net proceeds from the offering were contributed as capital to the Company's subsidiary bank to support further growth.

The Company has committed to irrevocably and unconditionally guarantee the following payments or distributions with respect to the preferred securities to the holders thereof to the extent that the Trust has not made such payments or distributions: (i) accrued and unpaid distributions, (ii) the redemption price, and (iii) upon a dissolution or termination of the trust, the lesser of the liquidation amount and all accrued and unpaid distributions and the amount of assets of the trust remaining available for distribution, in each case to the extent the Trust has funds available.

Note 8. Comprehensive Income

Comprehensive income is the total of net income and other comprehensive income. The following table summarizes the components of comprehensive income.

	For the Three Months		For the Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
<i>(In Thousands)</i>				
Net income	\$ 7,439	\$ 7,292	\$ 14,563	\$ 14,136
Other comprehensive income				
Unrealized loss on securities available-for-sale	(8,453)	(3,121)	(7,668)	(5,586)
Reclassification adjustment for losses (gains) realized in net income	14	133	(79)	(27)
Unrealized loss on derivative securities	727	675	475	1,503
Income tax effect	3,086	925	2,909	1,644
Total other comprehensive loss	(4,626)	(1,388)	(4,363)	(2,466)
Comprehensive income	\$ 2,813	\$ 5,904	\$ 10,200	\$ 11,670

Note 9. Commitments and Contingencies

In the normal course of business, the Company is a defendant in various legal actions and asserted claims. While the Company and its legal counsel are unable to assess the ultimate outcome of each of these matters with certainty, the resolution of these actions, singly or in the aggregate, should not have a material adverse effect on the financial condition, results of operations or cash flows of the Company.

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PART I. ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is provided to address information about First Community Bancshares, Inc.'s (the Company) financial condition and results of operations. This discussion and analysis should be read in conjunction with the Company's 2006 Annual Report on Form 10-K and the other financial information included in this report.

The Company is a multi-state financial holding company headquartered in Bluefield, Virginia, with total assets of \$2.17 billion at June 30, 2007. Through its community bank subsidiary, First Community Bank, N. A. (the Bank), the Company provides financial, trust and investment advisory services to individuals and commercial customers through fifty-six locations and four wealth management offices located in the four states of Virginia, West Virginia, North Carolina and Tennessee. The Bank is the parent of Investment Planning Consultants, Inc., a SEC-registered investment advisory firm that offers wealth management and investment advice. The Company's common stock is traded on the NASDAQ Global Select Market under the symbol FCBC.

FORWARD LOOKING STATEMENTS

The Company may from time to time make written or oral forward-looking statements, including statements contained in its filings with the SEC (including this Quarterly Report on Form 10-Q and the Exhibits hereto and thereto), in its reports to stockholders and in other communications which are made in good faith by the Company pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include, among others, statements with respect to the Company's beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (many of which are beyond the Company's control). The words may, could, should, would, believe, anticipate, estimate, expect, intend, plan expressions are intended to identify forward-looking statements. The following factors, among others, could cause the Company's financial performance to differ materially from that expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, market and monetary fluctuations; the timely development of competitive new products and services of the Company and the acceptance of these products and services by new and existing customers; the willingness of customers to substitute competitors products and services for the Company's products and services and vice versa; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; the effect of acquisitions, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions; the growth and profitability of the Company's non-interest or fee income being less than expected; unanticipated regulatory or judicial proceedings; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company. These factors are described in greater detail in Item 1A. Risk Factors of the Company's 2006 Annual Report on Form 10-K.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP) and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's consolidated financial position and consolidated results of operations.

Estimates, assumptions, and judgments are necessary principally when assets and liabilities are required to be recorded at estimated fair value, when a decline in the value of an asset carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded based upon the probability of occurrence of a future event. Carrying assets and liabilities at fair value

inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by third party sources, when available. When third party information

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is not available, valuation adjustments are estimated by management primarily through the use of internal modeling techniques and appraisal estimates.

The Company's accounting policies are fundamental to understanding Management's Discussion and Analysis of Financial Condition and Results of Operation. The disclosures presented in the Notes to the Consolidated Financial Statements and in Management's Discussion and Analysis provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses, accounting for acquisitions and intangible assets, and accounting for income taxes as the accounting areas that require the most subjective or complex judgments. The identified critical accounting policies are described in detail in the Company's 2006 Annual Report on Form 10-K. There have been no material changes in the Company's critical accounting policies since December 31, 2006.

COMPANY OVERVIEW

The Company is a full service commercial bank holding company which operates within the four-state region of Virginia, West Virginia, North Carolina, and Tennessee. The Company operates through the Bank, and offers a wide range of financial services. The Company reported total assets of \$2.17 billion at June 30, 2007, and operates through fifty-six offices and four wealth management offices.

The Company funds its lending activities primarily through the retail deposit operations of its branch banking network. Retail and wholesale repurchase agreements and borrowings from the Federal Home Loan Bank (FHLB) provide additional funding as needed. The Company invests its funds primarily in loans to retail and commercial customers. In addition to loans, the Company also invests a portion of its funds in various debt securities, including those of United States agencies, state and political subdivisions, and certain corporate notes and debt instruments. The Company also maintains overnight interest-bearing balances with the FHLB and correspondent banks. The difference between interest earned on assets and interest paid on liabilities is the Company's primary source of earnings. The Company also conducts asset management activities through its Trust Division and its registered investment advisory firm, Investment Planning Consultants. These two divisions manage assets with a market value of over \$840 million. These assets are not assets of the Company, but are managed under various fee-based arrangements as fiduciary or agent.

MERGERS, ACQUISITIONS AND BRANCHING ACTIVITY

In March 2007, the Company opened two new branch locations in the Winston-Salem, North Carolina, area. The Company currently has plans to open five more branch offices during 2007. In Richmond, Virginia, locations are planned for the Chesterfield Towne Center and on Mechanicsville Turnpike, Route 360. In West Virginia, locations are planned for Daniels, Summersville, and Princeton. These locations are all in various stages of construction, and are anticipated to be open by the third and fourth quarters of 2007.

In December 2006, the Company completed the sale of its Rowlesburg, West Virginia, branch location. At the time of the sale, the branch had deposits and repurchase agreements totaling approximately \$10.6 million and loans of approximately \$2.2 million. The transaction resulted in a pre-tax gain of approximately \$333 thousand.

In November 2006, the Company completed the acquisition of Investment Planning Consultants, Inc. (IPC), a registered investment advisory firm. In connection with the initial payment of approximately \$1.47 million, the Company issued 39,874 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of IPC are entitled to additional consideration aggregating up to \$1.43 million in the form of the Company's common stock, valued at the time of issuance, if certain future operating performance targets are met. If those operating targets are met, the value of the consideration ultimately paid will be added to the cost of the acquisition, which will increase the amount of goodwill related to the acquisition.

In June 2006, the Company sold its Drakes Branch, Virginia, branch office. At the time of the sale, the branch had deposits and repurchase agreements totaling approximately \$16.4 million and loans of approximately \$1.9 million. The transaction resulted in a gain of approximately \$702 thousand. The sale of this and the previously referenced Rowlesburg branch were designed to enhance the efficiency of the Company's branch network.

Table of Contents**RESULTS OF OPERATIONS****Overview**

Net income for the three months ended June 30, 2007, was \$7.44 million, or \$0.66 per basic and diluted share, compared with \$7.29 million or \$0.65 per basic and diluted share for the three months ended June 30, 2006, an improvement of \$147 thousand, or 2.02%. Return on average equity for the three months ended June 30, 2007, was 13.56% compared with 14.74% for the three months ended June 30, 2006. Return on average assets was 1.40% for the three months ended June 30, 2007, compared with 1.47% for the same period in 2006.

Net income for the six months ended June 30, 2007, was \$14.56 million, or \$1.29 per basic and \$1.28 per diluted share, compared with \$14.14 million or \$1.26 per basic and \$1.25 per diluted share for the six months ended June 30, 2006, an improvement of \$427 thousand, or 3.02%. Return on average equity for the six months ended June 30, 2007, was 13.45% compared with 14.42% for the six months ended June 30, 2006. Return on average assets was 1.41% for the six months ended June 30, 2007, compared with 1.45% for the same period in 2006.

Net Interest Income Quarterly Comparison (See Table I)

Net interest income, the largest contributor to earnings, was \$17.01 million for the three months ended June 30, 2007, compared with \$18.17 million for the corresponding period in 2006, a decrease of \$1.16 million, or 6.38%.

Tax-equivalent net interest income totaled \$18.19 million for the three months ended June 30, 2007, a decrease of \$975 thousand from \$19.16 million for the second quarter of 2006. The net decrease was due mostly to increases in rates paid on interest-bearing liabilities which outpaced increases in the rates earned on loans and securities.

Compared with the second quarter of 2006, average earning assets increased \$134.03 million while interest-bearing liabilities increased \$133.11 million. The yield on average earning assets decreased by three basis points to 6.89% from 6.92%. Total cost of interest-bearing liabilities increased 50 basis points between the second quarter of 2006 and 2007, which resulted in a net interest rate spread that was 53 basis points lower at 3.28% compared with 3.81% for the same period last year. The Company's tax-equivalent net interest margin of 3.78% for the three months ended June 30, 2007, decreased 50 basis points from 4.28% for the same period of 2006.

The rate earned on loans increased to 7.49% from 7.40%, which is attributable to the general rise in market rates of interest since the beginning of 2006. Declines in the average portfolio balances contributed largely to a net \$1.10 million decrease in tax-equivalent loan interest income compared with the second quarter of 2006.

The largest contributors to the increase in the tax-equivalent interest income in 2007 were the increases in both average balance and rate earned on the securities portfolio. During the three months ended June 30, 2007, the tax-equivalent yield on available-for-sale securities increased 23 basis points to 5.75%, while the average balance increased by \$223.32 million. The average tax-equivalent yield increased due to the addition of higher rate securities and the reduction of lower rate securities. As net payoffs in the loan portfolio are realized, the Company has been reinvesting those funds in securities. The average balance of the held-to-maturity securities portfolio continued to decline as securities matured and called and were not replaced.

Compared with the second quarter of 2006, average interest-bearing balances with banks decreased to \$32.30 million during the second quarter of 2007, as the yield increased 25 basis points to 4.90%. Interest-bearing balances with banks is made up largely of excess liquidity bearing overnight market rates. The rate earned on those balances has risen along with increases in short-term benchmark interest rates. The balance has decreased as the Company has invested in higher yielding securities.

Compared with the same period in 2006, the average balances of interest-bearing demand and savings deposits decreased \$932 thousand and \$31.07 million, respectively, for the three months ended June 30, 2007. The average rate paid on interest-bearing demand deposits increased by two basis points, while the average rate paid on savings increased 20 basis points. Average time deposits increased \$21.39 million while the average rate paid increased 68 basis points from 3.79% in 2006 to 4.47% in 2007. The level of average non-interest-bearing demand deposits decreased \$5.76 million to \$234.54 million during the quarter ended June 30, 2007, compared with the corresponding period of the prior year.

The changes in average deposits between the two quarters include the effect of the previously disclosed sale of the Company's Drakes Branch, Virginia, and Rowlesburg, West Virginia, branch offices. The average deposit balances held by those two branches in the second quarter of 2006 totaled \$26.07 million.

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Compared with the same period in 2006, average federal funds purchased and repurchase agreements increased \$92.33 million to \$228.86 million during the second quarter of 2007, while the average rate increased 51 basis points. The Company added approximately \$50.00 million of wholesale repurchase agreement funding in the latter part of 2006. The average balance of FHLB borrowings and other long-term debt increased by \$51.38 million in 2007 to \$255.55 million, while the rate paid on those borrowings increased only five basis points. The Company borrowed an additional \$100 million in FHLB advances early in the second quarter that have a weighted-average cost of 4.18%.

Net Interest Income Year-to-Date Comparison (See Table II)

Net interest income was \$34.03 million for the six months ended June 30, 2007, compared with \$36.24 million for the corresponding period in 2006, a decrease of \$2.21 million, or 6.10%. Tax-equivalent net interest income totaled \$36.24 million for the six months ended June 30, 2007, a decrease of \$1.98 million from \$38.22 million for the first half of 2006. The net decrease was due mostly to increases in rates paid on interest-bearing liabilities which outpaced increases in the rates earned on loans and securities.

Compared with the first half of 2006, average earning assets increased \$92.43 million while interest-bearing liabilities increased \$95.93 million. The yield on average earning assets increased nine basis points to 6.94% from 6.85%. Total cost of interest-bearing liabilities increased 56 basis points during the first half of 2007, which resulted in a net interest rate spread that was 47 basis points lower at 3.37% compared with 3.84% for the same period last year. The Company's tax-equivalent net interest margin of 3.87% for the six months ended June 30, 2007, decreased 43 basis points from 4.30% for the same period of 2006.

The rate earned on loans increased to 7.52% from 7.34%, which is attributable to the general rise in market rates of interest since the beginning of 2006. Declines in the average portfolio balances contributed largely to a net \$1.51 million decrease in tax-equivalent loan interest income compared with the first half of 2006.

The largest contributors to the increase in the tax-equivalent interest income in 2007 were the increases in both average balance and rate earned on the securities portfolio. During the six months ended June 30, 2007, the tax-equivalent yield on available-for-sale securities increased 35 basis points to 5.74%, while the average balance increased by \$176.40 million. The average tax-equivalent yield increased due to the addition of higher rate securities and the reduction of lower rate securities. As net payoffs in the loan portfolio are realized, the Company has been reinvesting those funds in securities. The average balance of the held-to-maturity securities portfolio continued to decline as securities matured and called and were not replaced.

Compared with the first half of 2006, average interest-bearing balances with banks decreased to \$27.79 million during the first half of 2007, as the yield increased 41 basis points to 4.85%. Interest-bearing balances with banks is made up largely of excess liquidity bearing overnight market rates. The rate earned on those balances has risen along with increases in short-term benchmark interest rates. The balance has decreased as the Company has invested in higher yielding securities.

Compared with the same period in 2006, the average balances of interest-bearing demand and savings deposits decreased \$720 thousand and \$35.58 million, respectively, for the six months ended June 30, 2007. The average rate paid on interest-bearing demand deposits increased by one basis point, while the average rate paid on savings increased 25 basis points. Average time deposits increased \$21.14 million while the average rate paid increased 75 basis points from 3.67% in 2006 to 4.42% in 2007. The level of average non-interest-bearing demand deposits decreased slightly to \$232.07 million during the six months ended June 30, 2007, compared with the corresponding period of the prior year.

The changes in average deposits between the two periods include the effect of the previously disclosed sale of the Company's Drakes Branch, Virginia, and Rowlesburg, West Virginia, branch offices. The average deposit balances held by those two branches in the first half of 2006 totaled \$26.40 million.

Compared with the same period in 2006, average federal funds purchased and repurchase agreements increased \$88.13 million to \$221.70 million during the first half of 2007, while the average rate increased 68 basis points. The Company added approximately \$50.00 million of wholesale repurchase agreement funding in the latter part of 2006. The average balance of FHLB borrowings and other long-term debt increased by \$22.96 million in 2007 to \$225.08 million, while the rate paid on those borrowings increased 17 basis points. The Company borrowed an additional \$100 million in FHLB advances early in the second quarter that have a weighted-average cost of 4.18%.

Table of Contents**Table I****AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS**

	Three Months Ended June 30, 2007			Three Months Ended June 30, 2006		
	Average Balance	Interest (1)	Yield/ Rate (1) <i>(Dollars in Thousands)</i>	Average Balance	Interest (1)	Yield/ Rate (1)
ASSETS						
Earning Assets:						
Loans: (2)						
Taxable	\$ 1,251,696	\$ 23,379	7.49%	\$ 1,327,278	\$ 24,487	7.40%
Tax-exempt	1,983	38	7.69%	1,490	30	8.08%
Total	1,253,679	23,417	7.49%	1,328,768	24,517	7.40%
Securities available for sale:						
Taxable	439,504	6,024	5.50%	257,838	3,218	5.01%
Tax-exempt	189,526	2,993	6.33%	147,869	2,367	6.42%
Total	629,030	9,017	5.75%	405,707	5,585	5.52%
Securities held to maturity:						
Taxable	378	6	6.37%	388	5	5.17%
Tax-exempt	15,858	316	7.99%	20,990	427	8.16%
Total	16,236	322	7.95%	21,378	432	8.11%
Interest-bearing deposits	32,302	395	4.90%	41,361	479	4.65%
Total Earning Assets	1,931,247	33,151	6.89%	1,797,214	31,013	6.92%
Other assets	203,365			187,527		
TOTAL ASSETS	\$ 2,134,612			\$ 1,984,741		
LIABILITIES						
Interest-bearing liabilities:						
Demand deposits	\$ 147,570	\$ 118	0.32%	\$ 148,502	\$ 111	0.30%
Savings deposits	324,759	1,776	2.19%	355,826	1,761	1.99%
Time deposits	704,611	7,854	4.47%	683,221	6,454	3.79%
Total interest-bearing deposits	1,176,940	9,748	3.32%	1,187,549	8,326	2.81%
Federal funds purchased and repurchase agreements	228,856	2,206	3.87%	136,522	1,142	3.36%
FHLB borrowings and other long-term debt	255,554	3,011	4.73%	204,172	2,384	4.68%
	1,661,350	14,965	3.61%	1,528,243	11,852	3.11%

Total interest-bearing liabilities

Non-interestbearing demand deposits	234,536	240,296
Other liabilities	18,737	17,762
Stockholders Equity	219,989	198,440

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY

\$ 2,134,612	\$ 1,984,741
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Net Interest Income, Tax Equivalent

\$ 18,186	\$ 19,161
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Net Interest Rate Spread (3)

3.28%	3.81%
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Net Interest Margin (4)

3.78%	4.28%
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(1) Fully Taxable Equivalent (FTE) at the rate of 35%. The FTE basis adjusts for the tax benefits of income on certain tax-exempt loans and investments using the federal statutory rate of 35% for each period presented. The Company believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and non-taxable

amounts.

- (2) Non-accrual loans are included in average balances outstanding but with no related interest income during the period of non-accrual.
- (3) Represents the difference between the yield on earning assets and cost of funds.
- (4) Represents tax equivalent net interest income divided by average interest-earning assets.

Table of Contents**Table II****AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS**

	Six Months Ended June 30, 2007			Six Months Ended June 30, 2006		
	Average Balance	Interest (1)	Yield/ Rate (1) <i>(Dollars in Thousands)</i>	Average Balance	Interest (1)	Yield/ Rate (1)
ASSETS						
Earning Assets:						
Loans: (2)						
Taxable	\$ 1,257,722	\$ 46,877	7.52%	\$ 1,330,375	\$ 48,391	7.34%
Tax-exempt	1,898	71	7.54%	1,531	62	8.17%
Total	1,259,620	46,948	7.52%	1,331,906	48,453	7.34%
Securities available for sale:						
Taxable	405,390	10,999	5.47%	254,702	6,091	4.82%
Tax-exempt	175,701	5,553	6.37%	149,991	4,726	6.35%
Total	581,091	16,552	5.74%	404,693	10,817	5.39%
Securities held to maturity:						
Taxable	380	12	6.37%	389	10	5.18%
Tax-exempt	17,611	699	8.00%	21,938	876	8.05%
Total	17,991	711	7.97%	22,327	886	8.00%
Interest-bearing deposits	27,788	669	4.85%	35,134	774	4.44%
Total Earning Assets	1,886,490	64,880	6.94%	1,794,060	60,930	6.85%
Other assets	199,588			178,179		
TOTAL ASSETS	\$ 2,086,078			\$ 1,972,239		
LIABILITIES						
Interest-bearing liabilities:						
Demand deposits	\$ 146,770	\$ 229	0.31%	\$ 147,490	\$ 217	0.30%
Savings deposits	322,223	3,449	2.16%	357,804	3,393	1.91%
Time deposits	700,884	15,370	4.42%	679,745	12,363	3.67%
Total interest-bearing deposits	1,169,877	19,048	3.28%	1,185,039	15,973	2.72%
Federal funds purchased and repurchase agreements	221,695	4,241	3.86%	133,566	2,103	3.18%
FHLB borrowings and other long-term debt	225,082	5,347	4.79%	202,118	4,634	4.62%
	1,616,654	28,636	3.57%	1,520,723	22,710	3.01%

Total interest-bearing liabilities

Non-interestbearing demand deposits	232,069	235,987
Other liabilities	18,949	17,806
Stockholders Equity	218,406	197,723

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY

\$ 2,086,078	\$ 1,972,239
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Net Interest Income, Tax Equivalent

\$ 36,244	\$ 38,220
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Net Interest Rate Spread (3)

3.37%	3.84%
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Net Interest Margin (4)

3.87%	4.30%
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(1) Fully Taxable Equivalent (FTE) at the rate of 35%. The FTE basis adjusts for the tax benefits of income on certain tax-exempt loans and investments using the federal statutory rate of 35% for each period presented. The Company believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and non-taxable

amounts.

- (2) Non-accrual loans are included in average balances outstanding but with no related interest income during the period of non-accrual.
- (3) Represents the difference between the yield on earning assets and cost of funds.
- (4) Represents tax equivalent net interest income divided by average interest-earning assets.

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The following table summarizes the changes in tax-equivalent interest earned and paid resulting from changes in the volume of earning assets and paying liabilities and changes in their interest rates. The changes in interest due to both rate and volume have been allocated to the volume and rate columns in proportion to dollar amounts.

<i>(In Thousands)</i>	Three Months Ended June 30, 2007, Compared to 2006			Six Months Ended June 30, 2007, Compared to 2006		
	\$ Increase/(Decrease) due to Volume	Rate	Total	\$ Increase/(Decrease) due to Volume	Rate	Total
Interest Earned On:						
Loans (1)	\$ (1,384)	\$ 284	\$ (1,100)	\$ (2,628)	\$ 1,123	\$ (1,505)
Securities available for sale (1)	2,934	498	3,432	4,414	1,321	5,735
Securities held to maturity (1)	(105)	(5)	(110)	(173)	(2)	(175)
Interest-bearing deposits with other banks	(105)	21	(84)	(162)	57	(105)
Total interest-earning assets	1,340	798	2,138	1,451	2,499	3,950
Interest Paid On:						
Demand deposits	(1)	8	7	(1)	13	12
Savings deposits	(154)	169	15	(337)	393	56
Time deposits	202	1,198	1,400	384	2,623	3,007
Fed funds purchased and repurchase agreements	772	292	1,064	1,388	750	2,138
FHLB borrowings and other long-term debt	600	27	627	527	186	713
Total interest-bearing liabilities	1,419	1,694	3,113	1,961	3,965	5,926
Change in net interest income, tax-equivalent	\$ (79)	\$ (896)	\$ (975)	\$ (510)	\$ (1,466)	\$ (1,976)

(1) Fully taxable equivalent using a rate of 35%.

Provision and Allowance for Loan Losses

The allowance for loan losses was \$13.93 million at June 30, 2007, \$14.55 million at December 31, 2006 and \$14.71 million at June 30, 2006. The Company's allowance for loan loss activity for the three- and six-month periods ended June 30, 2007 and 2006, is as follows:

<i>(In Thousands)</i>	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Allowance for loan losses				
Beginning balance	\$ 14,510	\$ 14,797	\$ 14,549	\$ 14,736
Provision for loan losses		811		1,219
Charge-offs	(911)	(1,389)	(1,804)	(2,104)

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Recoveries	335	491	1,189	859
Net charge-offs	(576)	(898)	(615)	(1,245)
Ending balance	\$ 13,934	\$ 14,710	\$ 13,934	\$ 14,710

The total allowance for loan losses to loans held for investment ratio was 1.12% at June 30, 2007, compared with 1.13% at December 31, 2006, and 1.12% at June 30, 2006. Management considers the allowance adequate based upon its analysis of the portfolio as of June 30, 2007. However, no assurances can be made that future adjustments to the allowance for loan losses will not be necessary as a result of increases in non-performing loans and other factors. Throughout the first half of 2007, the Company had excellent experience with charge-offs and recoveries with net charge-offs of \$576 thousand and \$615 thousand for the second quarter and year-to-date periods, respectively. Net charge-offs for the

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second quarter and the first half of 2007 compare very favorably with the comparable periods in 2006. The lower net charge-offs and improving credit quality metrics led the Company to make no provision for loan losses for the first half of 2007.

Non-interest Income

Non-interest income consists of all revenues which are not included in interest and fee income related to earning assets. Non-interest income for the second quarter of 2007 was \$5.55 million compared with \$5.52 million in the same period of 2006, an increase of 0.49%. Wealth management revenues increased \$273 thousand to \$1.01 million, reflective of the additional revenues generated by the IPC acquisition. Service charges on deposit accounts was flat between the comparable quarterly periods, however the Bank had two more branches during the 2006 period. Other service charges, commissions, and fees increased \$126 thousand, or 17.72%. Other operating income was \$1.01 million, a decrease of \$503 thousand compared with 2006. Included in the second quarter 2006 results was the \$702 thousand gain on the sale of the Drakes Branch, Virginia, banking office.

Non-interest income for the first half of 2007 was \$10.76 million compared with \$10.67 million in 2006, an increase of 0.88%. Wealth management revenues increased \$608 thousand to \$2.02 million, also reflective of the addition of IPC. In the first half of 2007, service charges on deposit accounts were also flat compared to 2006, however the two branches sold were included in the 2006 amount. Other service charges, commissions, and fees increased \$256 thousand, or 17.64%. Other operating income was \$1.80 million, a decrease of \$862 thousand compared with 2006. In addition to the branch sale gain, the first half of 2006 included a \$676 thousand partial recovery from a fraud claim that is more than a decade old.

During the second quarter and first half of 2007, securities gains of \$30 thousand and \$159 thousand, respectively, were realized, compared with a loss of \$94 thousand and a gain \$66 thousand in the respective comparable periods in 2006.

Non-interest Expense

Non-interest expense totaled \$12.08 million for the quarter ended June 30, 2007, decreasing \$513 thousand, or 4.08%, from the same period in 2006. Year-to-date non-interest expense totaled \$24.23 million compared with \$25.92 million for the same period in 2006, a decrease of \$1.69 million, or 6.51%. The quarterly and year-to-date decreases are the result of the Company's continuing efforts to control costs and capture efficiencies available from recent acquisitions and changes in the Company's organization structure. Those cost control efforts began in earnest in the second quarter of 2006 and focused on consolidation of backroom operations and a reduction of branch staffing levels. The results of those cost control measures are decreases in second quarter and year-to-date salaries and benefits of \$617 thousand, or 9.10%, and \$2.11 million, or 14.35%, respectively, from the comparable prior year periods. All other operating expenses increased only \$104 thousand and \$419 thousand between the comparable periods.

Income Tax Expense

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are commonly referred to as permanent differences. The most significant permanent differences for the Company include income on state and municipal securities which are exempt from federal income tax, certain dividend payments which are deductible by the Company, and tax credits generated by investments in low income housing and historic rehabilitations.

For the second quarter of 2007, income taxes were \$3.05 million compared with \$3.00 million for the second quarter of 2006. For the quarters ended June 30, 2007 and 2006, the effective tax rates were 29.06% and 29.16%, respectively. For the first six months of 2007, income taxes were \$6.00 million compared with \$5.63 million for the first six months of 2006. For the six-month periods ended June 30, 2007 and 2006, the effective tax rates were 29.16% and 28.48%, respectively. The effective tax rate was higher during the first half 2007 due to slightly lower proportions of tax-free municipal security interest income than in the comparable period of 2006.

Table of Contents**FINANCIAL CONDITION**

Total assets at June 30, 2007, increased \$134.90 million to \$2.17 billion from December 31, 2006, an annualized growth rate of 13.38%. The growth reflects deposit growth, capitalized earnings, and additional borrowings, which were invested in various debt securities.

Securities

Available-for-sale securities were \$658.90 million at June 30, 2007, compared with \$508.37 million at December 31, 2006, an increase of \$150.53 million. The Company has continued to reinvest net paydowns from the loan portfolio through the purchase of state and federal securities, various mortgage-backed securities, and trust-preferred obligations.

Held-to-maturity securities declined to \$13.18 million at June 30, 2007, reflective of continuing paydowns, maturities, and calls within the portfolio. The market value of investment securities held-to-maturity was 101.61% and 101.65% of book value at June 30, 2007, and December 31, 2006, respectively.

The Company's available-for-sale securities portfolio is reported at fair value. The fair value of most securities is determined based on quoted market prices. If quoted market prices are not available, fair value is determined based on quoted prices of similar instruments. Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer and the Company's intent and ability to hold the security to recovery or maturity. Management does not believe any unrealized loss, individually or in the aggregate, as of June 30, 2007, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes the decrease in value is attributable to changes in market interest rates and not the credit quality of the issuer.

Loan Portfolio

Loans Held for Sale: The \$1.82 million balance of loans held for sale at June 30, 2007, represents mortgage loans that are sold to investors on a best efforts basis. Accordingly, the Company does not retain the interest rate risk involved in the commitment. The gross notional amount of outstanding commitments at June 30, 2007, was \$12.44 million on 89 loans.

Loans Held for Investment: Total loans held for investment were \$1.24 billion at June 30, 2007, a slight decline from \$1.28 billion at December 31, 2006, and \$1.32 billion at June 30, 2006. The average loan to deposit ratio decreased to 88.82% for the second quarter of 2007, compared with 92.97% for the fourth quarter of 2006 and 93.06% for the second quarter of 2006. The 2007 year-to-date average loans of \$1.26 billion decreased \$72.29 million when compared with the average for the first six months of 2006 of \$1.33 billion.

The held for investment loan portfolio continues to be diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition as of June 30, 2007, December 31, 2006, and June 30, 2006.

<i>(Dollars in Thousands)</i>	June 30, 2007		December 31, 2006		June 30, 2006	
	Amount	Percent	Amount	Percent	Amount	Percent
Loans Held for Investment						
Commercial and agricultural	\$ 96,835	7.79%	\$ 106,645	8.30%	\$ 108,749	8.25%
Commercial real estate	394,418	31.73%	421,067	32.77%	434,161	32.92%
Residential real estate	498,156	40.07%	506,370	39.41%	514,019	38.97%
Construction	166,010	13.35%	158,566	12.34%	160,685	12.18%
Consumer	83,665	6.73%	88,666	6.90%	99,018	7.51%
Other	3,992	0.33%	3,549	0.28%	2,311	0.17%
Total	\$ 1,243,076	100.00%	\$ 1,284,863	100.00%	\$ 1,318,943	100.00%

Loans Held for Sale	\$	1,818	\$	781	\$	1,293
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Table of Contents**Non-Performing Assets**

Non-performing assets include loans on non-accrual status, loans contractually past due 90 days or more and still accruing interest, and other real estate owned (OREO). Non-performing assets were \$3.50 million at June 30, 2007, \$4.07 million at December 31, 2006, and \$3.91 million at June 30, 2006. The percentage of non-performing assets to total loans, and OREO was 0.28% at June 30, 2007, 0.32% at December 31, 2006, and 0.29% at June 30, 2006.

The following schedule details non-performing assets by category at the close of each of the quarters ended June 30, 2007 and 2006, and December 31, 2006.

<i>(In Thousands)</i>	June 30, 2007	December 31, 2006	June 30, 2006
Non-accrual	\$ 2,910	\$ 3,813	\$ 2,937
Ninety days past due and accruing			
Other real estate owned	593	258	910
Total non-performing assets	\$ 3,503	\$ 4,071	\$ 3,847
Restructured loans performing in accordance with modified terms	\$ 256	\$ 272	\$ 289

At June 30, 2007, non-accrual loans decreased \$903 thousand from December 31, 2006, and decreased \$27 thousand from June 30, 2006. Ongoing activity within the classification and categories of non-performing loans continues to include collections on delinquencies, foreclosures and movements into or out of the non-performing classification as a result of changing customer business conditions. OREO was \$593 thousand at June 30, 2007, and is carried at the lesser of estimated net realizable value or cost.

Deposits and Other Borrowings

Total deposits increased by \$27.19 million during the first six months of 2007. Non interest-bearing demand deposits decreased by \$3.35 million and interest-bearing demand deposits increased \$2.50 million. Savings increased \$16.18 million and time deposits increased \$11.86 million.

Securities sold under repurchase agreements increased \$16.80 million in the first six months of 2007 to \$217.99 million. There were no federal funds purchased outstanding at June 30, 2007.

The Company borrowed an additional \$100.00 million in FHLB advances during the second quarter. The weighted-average interest rate of the 10-year callable advances is 4.18%. The advances effectively refinanced and lowered the borrowing cost of the federal funds purchased position of \$45.00 million at March 31, 2007. The remaining funds were invested in securities and deposited in bank accounts bearing interest rates approximating the target federal funds rate.

Stockholders Equity

Total stockholders equity increased \$3.53 million from December 31, 2006, as the Company continued to balance capital adequacy and returns to stockholders. The increase in equity was due mainly to net earnings of \$14.56 million, less dividends paid to stockholders of \$6.08 million, net changes of \$417 thousand to treasury stock, and other comprehensive loss of \$4.36 million.

Risk-based capital guidelines and the leverage ratio measure capital adequacy of banking institutions. Risk-based capital guidelines weight balance sheet assets and off-balance sheet commitments based on inherent risks associated with the respective asset types. At June 30, 2007, the Company s total capital to risk-weighted assets ratio was 12.81% versus 12.69% at December 31, 2006. The Company s Tier 1 capital to risk-weighted assets ratio was 11.79% at June 30, 2007, compared with 11.60% at December 31, 2006. The Company s Tier 1 leverage ratio at June 30, 2007, was 8.36% compared with 8.50% at December 31, 2006. All of the Company s regulatory capital ratios exceed the current well-capitalized levels prescribed for banks.

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PART I. ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Liquidity and Capital Resources

At June 30, 2007, the Company maintained a significant level of liquidity in the form of cash and cash equivalent balances of \$74.26 million, investment securities available-for-sale of \$658.90 million, and FHLB credit availability of approximately \$157