

FIRST COMMUNITY BANCSHARES INC /NV/

Form 10-Q

August 11, 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 quarter ended June 30, 2008  
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, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

(Do not check if a 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.

Class Common Stock, \$1.00 Par Value; 10,950,078 shares outstanding as of August 1, 2008

FIRST COMMUNITY BANCSHARES, INC.  
FORM 10-Q  
For the quarter ended June 30, 2008  
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CONSOLIDATED BALANCE SHEETS**

|   | <b>June 30,<br/>2008<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2007</b> |
|---|--|----------------------------------|
| <i>(Dollars in Thousands, Except Per Share Data)</i>  |  |                                  |
| <b>Assets</b>   |  |                                  |
| Cash and due from banks   | \$ 44,672                                | \$ 50,051                        |
| Interest-bearing balances with banks  | 10,745                                   | 2,695                            |
| Total cash and cash equivalents   | 55,417                                   | 52,746                           |
| Securities available-for-sale (amortized cost of \$646,657 at June 30, 2008;<br>\$674,937 at December 31, 2007) | 598,438                                  | 664,120                          |
| Securities held-to-maturity (fair value of \$10,661 at June 30, 2008; \$12,298 at<br>December 31, 2007)         | 10,511                                   | 12,075                           |
| Loans held for sale   | 1,522                                    | 811                              |
| Loans held for investment, net of unearned income   | 1,181,107                                | 1,225,502                        |
| Less allowance for loan losses  | 13,433                                   | 12,833                           |
| Net loans held for investment   | 1,167,674                                | 1,212,669                        |
| Premises and equipment  | 50,075                                   | 48,383                           |
| Other real estate owned   | 500                                      | 545                              |
| Interest receivable   | 9,992                                    | 12,465                           |
| Goodwill and other intangible assets  | 71,181                                   | 70,056                           |
| Other assets  | 88,377                                   | 75,968                           |
| Total Assets  | \$ 2,053,687                             | \$ 2,149,838                     |
| <b>Liabilities</b>  |  |                                  |
| Deposits:   |  |                                  |
| Noninterest-bearing   | \$ 224,716                               | \$ 224,087                       |
| Interest-bearing  | 1,114,691                                | 1,169,356                        |
| Total Deposits  | 1,339,407                                | 1,393,443                        |
| Interest, taxes and other liabilities   | 18,695                                   | 21,454                           |
| Federal funds purchased   | 66,500                                   | 18,500                           |
| Securities sold under agreements to repurchase  | 215,610                                  | 207,427                          |
| FHLB borrowings and other indebtedness  | 216,862                                  | 291,916                          |
| Total Liabilities   | 1,857,074                                | 1,932,740                        |
| <b>Stockholders Equity</b>  |  |                                  |
| Preferred stock, par value undesignated; 1,000,000 shares authorized; none<br>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, 2008, and December 31, 2007, including 544,940 and 429,372 shares in treasury, respectively

|  |                  |                  |
|--|------------------|------------------|
| Additional paid-in capital                     | 108,926          | 108,825          |
| Retained earnings                              | 123,253          | 117,670          |
| Treasury stock, at cost                        | (17,328)         | (13,613)         |
| Accumulated other comprehensive loss           | (29,737)         | (7,283)          |
| <br>Total Stockholders' Equity                 | <br>196,613      | <br>217,098      |
| <br>Total Liabilities and Stockholders' Equity | <br>\$ 2,053,687 | <br>\$ 2,149,838 |

*See Notes to Consolidated Financial Statements.*

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

|  | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                  |
|--|---------------------------|-----------------|-------------------------|------------------|
|  | <b>June 30,</b>           |                 | <b>June 30,</b>         |                  |
| <i>(Dollars in Thousands, Except Per Share Data)</i>       | <b>2008</b>               | <b>2007</b>     | <b>2008</b>             | <b>2007</b>      |
| <b>Interest Income</b>                                     |                           |                 |                         |                  |
| Interest and fees on loans held for investment             | \$ 19,891                 | \$ 23,404       | \$ 41,128               | \$ 46,923        |
| Interest on securities-taxable                             | 5,467                     | 6,030           | 11,534                  | 11,011           |
| Interest on securities-nontaxable                          | 2,004                     | 2,150           | 4,067                   | 4,062            |
| Interest on deposits in banks                              | 71                        | 395             | 251                     | 669              |
| <b>Total interest income</b>                               | <b>27,433</b>             | <b>31,979</b>   | <b>56,980</b>           | <b>62,665</b>    |
| <b>Interest Expense</b>                                    |                           |                 |                         |                  |
| Interest on deposits                                       | 7,118                     | 9,748           | 15,859                  | 19,048           |
| Interest on borrowings                                     | 3,690                     | 5,217           | 8,136                   | 9,588            |
| <b>Total interest expense</b>                              | <b>10,808</b>             | <b>14,965</b>   | <b>23,995</b>           | <b>28,636</b>    |
| Net interest income  | 16,625                    | 17,014          | 32,985                  | 34,029           |
| Provision for loan losses                                  | 937                       |                 | 1,260                   |                  |
| <b>Net interest income after provision for loan losses</b> | <b>15,688</b>             | <b>17,014</b>   | <b>31,725</b>           | <b>34,029</b>    |
| <b>Noninterest Income</b>                                  |                           |                 |                         |                  |
| Wealth management income                                   | 1,098                     | 1,005           | 1,997                   | 2,023            |
| Service charges on deposit accounts                        | 3,463                     | 2,662           | 6,562                   | 5,071            |
| Other service charges, commissions and fees                | 1,064                     | 837             | 2,185                   | 1,707            |
| Insurance commissions                                      | 1,146                     |                 | 2,490                   |                  |
| Gain on sale of securities                                 | 150                       | 30              | 1,970                   | 159              |
| Other operating income                                     | 803                       | 1,013           | 1,661                   | 1,802            |
| <b>Total noninterest income</b>                            | <b>7,724</b>              | <b>5,547</b>    | <b>16,865</b>           | <b>10,762</b>    |
| <b>Noninterest Expense</b>                                 |                           |                 |                         |                  |
| Salaries and employee benefits                             | 7,580                     | 6,165           | 15,370                  | 12,576           |
| Occupancy expense of bank premises                         | 1,256                     | 1,020           | 2,420                   | 2,077            |
| Furniture and equipment expense                            | 973                       | 780             | 1,874                   | 1,603            |
| Intangible amortization                                    | 158                       | 105             | 318                     | 208              |
| Prepayment penalty on FHLB advance                         |                           |                 | 1,647                   |                  |
| Other operating expense                                    | 4,792                     | 4,005           | 9,413                   | 7,769            |
| <b>Total noninterest expense</b>                           | <b>14,759</b>             | <b>12,075</b>   | <b>31,042</b>           | <b>24,233</b>    |
| Income before income taxes                                 | 8,653                     | 10,486          | 17,548                  | 20,558           |
| Income tax expense   | 2,415                     | 3,047           | 4,998                   | 5,995            |
| <b>Net income</b>  | <b>\$ 6,238</b>           | <b>\$ 7,439</b> | <b>\$ 12,550</b>        | <b>\$ 14,563</b> |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Basic earnings per common share                        | \$ 0.57    | \$ 0.66    | \$ 1.14    | \$ 1.29    |
| Diluted earnings per common share                      | \$ 0.56    | \$ 0.66    | \$ 1.13    | \$ 1.28    |
| Dividends declared per common share                    | \$ 0.28    | \$ 0.27    | \$ 0.56    | \$ 0.54    |
| Weighted average basic shares outstanding              | 10,992,301 | 11,260,868 | 11,011,116 | 11,260,126 |
| Weighted average diluted shares outstanding            | 11,073,440 | 11,320,227 | 11,091,714 | 11,334,486 |
| <i>See Notes to Consolidated Financial Statements.</i> |            |            |            |            |

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

| <i>(In Thousands)</i>   | <b>Six Months Ended<br/>June 30,</b> |               |
|---|--------------------------------------|---------------|
|   | <b>2008</b>                          | <b>2007</b>   |
| Operating activities:   |                                      |               |
| Net Income  | \$ 12,550                            | \$ 14,563     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                      |               |
| Provision for loan losses   | 1,260                                |               |
| Depreciation and amortization of premises and equipment                           | 1,855                                | 1,585         |
| Intangible amortization   | 318                                  | 208           |
| Net investment amortization and accretion   | (526)                                | 282           |
| Net gain on the sale of assets  | (1,929)                              | (154)         |
| Mortgage loans originated for sale  | (22,964)                             | (23,737)      |
| Proceeds from sales of mortgage loans   | 22,376                               | 22,831        |
| Gain on sales of loans  | (123)                                | (131)         |
| Deferred income tax benefit   | (330)                                | (164)         |
| Decrease (increase) in interest receivable  | 2,473                                | (751)         |
| Other operating activities, net   | (1,765)                              | (3,494)       |
| <br>Net cash provided by operating activities                                     | <br>13,195                           | <br>11,038    |
| <br>Investing activities:   |                                      |               |
| Proceeds from sales of securities available-for-sale                              | 73,731                               | 827           |
| Proceeds from maturities and calls of securities available-for-sale               | 54,521                               | 16,784        |
| Proceeds from maturities and calls of securities held-to-maturity                 | 1,578                                | 6,809         |
| Purchase of securities available-for-sale   | (97,491)                             | (175,977)     |
| Net decrease in loans held for investment   | 43,740                               | 40,832        |
| Purchase of premises and equipment  | (3,549)                              | (6,977)       |
| <br>Net cash provided by (used in) investing activities                           | <br>72,530                           | <br>(117,702) |
| <br>Financing activities:   |                                      |               |
| Net increase in demand and savings deposits                                       | 4,139                                | 15,331        |
| Net (decrease) increase in time deposits  | (58,175)                             | 11,858        |
| Net increase (decrease) in federal funds purchased                                | 48,000                               | (7,700)       |
| Net increase in securities sold under agreement to repurchase                     | 8,183                                | 16,802        |
| Net (decrease) increase in FHLB and other borrowings                              | (75,054)                             | 93,716        |
| Proceeds from the exercise of stock options                                       | 97                                   | 681           |
| Excess tax benefit from stock-based compensation                                  | 22                                   | 284           |
| Acquisition of treasury stock   | (4,112)                              | (1,729)       |
| Dividends paid  | (6,154)                              | (6,079)       |
| <br>Net cash (used in) provided by financing activities                           | <br>(83,054)                         | <br>123,164   |

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|  |           |           |
|--|-----------|-----------|
| Increase in cash and cash equivalents            | 2,671     | 16,500    |
| Cash and cash equivalents at beginning of period | 52,746    | 57,759    |
| Cash and cash equivalents at end of period       | \$ 55,417 | \$ 74,259 |
| Supplemental information Noncash items           |           |           |
| Transfer of loans to other real estate           | \$ 637    | \$ 853    |

*See Notes to Consolidated Financial Statements.*

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

|   | Common    | Additional<br>Paid-in | Retained   | Treasury    | Accumulated<br>Other<br>Comprehensive<br>Income | Total      |
|---|-----------|-----------------------|------------|-------------|---|------------|
| <i>(Dollars in Thousands)</i>                                     | Stock     | Capital               | Earnings   | Stock       | (Loss)  | Total      |
| 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 loss, 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 cash flow hedge                                |           |                       |            |             | 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        |
| Tax benefit from exercise of 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 |
| Balance January 1, 2008   | \$ 11,499 | \$ 108,825            | \$ 117,670 | \$ (13,613) | \$ (7,283)                                      | \$ 217,098 |
| Comprehensive income:   |           |                       |            |             |   |            |
| Net income  |           |                       | 12,550     |             |   | 12,550     |
| Other comprehensive loss, net of tax:                             |           |                       |            |             |   |            |
| Unrealized loss on securities available-for-sale                  |           |                       |            |             | (21,631)  | (21,631)   |
| Less reclassification adjustment for gains realized in net income |           |                       |            |             | (810)   | (810)      |
| Unrealized loss on cash flow hedge                                |           |                       |            |             | (13)  | (13)       |
| Comprehensive loss  |           |                       | 12,550     |             | (22,454)  | (9,904)    |
| Cumulative effect of change in accounting principle               |           |                       | (813)      |             |   | (813)      |
| Common dividends declared   |           |                       | (6,154)    |             |   | (6,154)    |
| Acquisition of 128,100 treasury shares                            |           |                       |            | (4,112)     |   | (4,112)    |
| Acquisition of GreenPoint Insurance Group - 7,728 shares issued   |           | 22                    |            | 245         |   | 267        |
| Equity-based compensation expense                                 |           | 107                   |            |             |   | 107        |
| Tax benefit from exercise of stock options                        |           | 29                    |            |             |   | 29         |
| Option exercises - 4,804 shares                                   |           | (57)                  |            | 152         |   | 95         |

Balance June 30, 2008 \$ 11,499 \$ 108,926 \$ 123,253 \$ (17,328) \$ (29,737) \$ 196,613

*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 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, 2007, has been derived from the audited consolidated financial statements included in the Company s 2007 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 2007 Annual Report on Form 10-K.

A more complete and detailed description of First Community s significant accounting policies is included within Footnote 1 of Item 8, Financial Statements and Supplementary Data in the Company s Annual Report on Form 10-K for December 31, 2007. 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 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.

Effective January 1, 2008, the Company operates within two business segments, community banking and insurance services.

*Recent Accounting Pronouncements*

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles ( SFAS 162 ). This statement establishes a framework for selecting accounting principles to be used in preparing financial statements that are presented in conformity with US GAAP. SFAS 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles, and is not expected to have an impact on the Company s consolidated financial statements. In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 ( SFAS 161 ). This statement requires enhanced disclosures about an entity s derivative and hedging activities in order to improve the transparency of financial reporting. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. This statement is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of SFAS 161 on its financial condition, results of operations and disclosures.

In December 2007, the FASB revised Statement No. 141, Business Combinations ( SFAS 141 ). This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. This statement recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase. This statement also defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquiree achieves control. Additionally this statement determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the

business combination. This statement is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact of SFAS 141R on its financial condition, results of operations and disclosures.

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In December 2007, the FASB issued Statement No. 160, *Non-controlling Interests in Consolidated Financial Statements* an amendment of ARB No. 51 ( SFAS 160 ). This statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding non-controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement amends ARB 51 to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective for fiscal years beginning after January 1, 2009. The Company is currently evaluating the impact of SFAS 160 on its financial condition, results of operations and disclosures.

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. The adoption of SFAS 159 did not have an effect on the Company's consolidated financial statements.

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 adoption of SFAS 157 did not have a significant effect on the Company's 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. On January 1, 2008, the Company made a cumulative effect adjustment to equity of \$813 thousand in connection with the adoption of EITF 06-4.

**Note 2. Mergers, Acquisitions, Branching Activity, and Subsequent Event**

On July 31, 2008, the Company signed a definitive agreement providing for the acquisition of Coddle Creek Financial Corp. ( Coddle Creek ) and its wholly-owned subsidiary, Mooresville Savings Bank, SSB ( Mooresville ). Mooresville is a \$156.56 million state-chartered savings bank headquartered in Mooresville, North Carolina. The definitive agreement provides for the payment of \$19.60 and .9046 shares of the Company's common stock for each outstanding share of Coddle Creek common stock. Coddle Creek and Mooresville will be merged with and into the Company and First Community Bank, N. A., respectively. The transaction is subject to regulatory approvals and approval by the stockholders of Coddle Creek. The merger is expected to close in the fourth quarter of 2008.

In September 2007, the Company completed the acquisition of GreenPoint Insurance Group, Inc. ( GreenPoint ), a High Point, North Carolina, insurance agency. In connection with the initial payment of approximately \$1.66 million, the Company issued 49,088 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of GreenPoint are entitled to additional consideration aggregating up to \$1.45 million in the form of cash or 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. The Company assumed \$5.57 million of debt in connection with the acquisition, of which approximately \$5.00 million was retired at closing. In March 2008, the Company issued 7,728 additional shares in connection with the acquisition, resulting in a goodwill adjustment of approximately \$267 thousand. The acquisition of GreenPoint has added a total \$9.09 million of

goodwill and intangibles.

In May 2008, the Company opened a new branch location in Summersville, West Virginia. In December 2007, the Company opened two new branch locations in the Richmond, Virginia, area. In November and October 2007, the Company opened new branch locations in Princeton and Daniels, West Virginia, respectively. In March 2007, the Company opened two new branch locations in the Winston-Salem, North Carolina, area.

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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 December 2007, the Company issued 13,401 additional shares in connection with the acquisition.

**Note 3. Investment Securities**

As of June 30, 2008, and December 31, 2007, the amortized cost and estimated fair value of available-for-sale securities were as follows:

| <i>(In Thousands)</i>             | <b>June 30, 2008</b>  |                         |                          | <b>Fair Value</b> |
|-----------------------------------|-----------------------|-------------------------|--------------------------|-------------------|
|                                   | <b>Amortized Cost</b> | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> |                   |
| U.S. Government agency securities | \$ 83,423             | \$ 577                  | \$                       | \$ 84,000         |
| States and political subdivisions | 175,898               | 1,248                   | (3,783)                  | 173,363           |
| Trust-preferred securities        | 164,362               |                         | (40,795)                 | 123,567           |
| Mortgage-backed securities        | 214,350               | 496                     | (5,780)                  | 209,066           |
| Equities                          | 8,624                 | 510                     | (692)                    | 8,442             |
| <b>Total</b>                      | <b>\$ 646,657</b>     | <b>\$ 2,831</b>         | <b>\$ (51,050)</b>       | <b>\$ 598,438</b> |

|                                   | <b>December 31, 2007</b> |                         |                          | <b>Fair Value</b> |
|-----------------------------------|--------------------------|-------------------------|--------------------------|-------------------|
|                                   | <b>Amortized Cost</b>    | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> |                   |
| U.S. Government agency securities | \$ 136,791               | \$ 2,446                | \$                       | \$ 139,237        |
| States and political subdivisions | 186,834                  | 2,667                   | (965)                    | 188,536           |
| Trust-preferred securities        | 164,731                  |                         | (14,106)                 | 150,625           |
| Mortgage-backed securities        | 177,984                  | 816                     | (2,073)                  | 176,727           |
| Equities                          | 8,597                    | 814                     | (416)                    | 8,995             |
| <b>Total</b>                      | <b>\$ 674,937</b>        | <b>\$ 6,743</b>         | <b>\$ (17,560)</b>       | <b>\$ 664,120</b> |

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As of June 30, 2008, and December 31, 2007, the amortized cost and estimated fair value of held-to-maturity securities were as follows:

| <i>(In Thousands)</i>             | <b>June 30, 2008</b>      |                             |                              |                       |
|-----------------------------------|---------------------------|-----------------------------|------------------------------|-----------------------|
|                                   | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| States and political subdivisions | \$ 10,136                 | \$ 151                      | \$ (1)                       | \$ 10,286             |
| Other securities                  | 375                       |                             |                              | 375                   |
| <b>Total</b>                      | <b>\$ 10,511</b>          | <b>\$ 151</b>               | <b>\$ (1)</b>                | <b>\$ 10,661</b>      |

|                                   | <b>December 31, 2007</b>  |                             |                              |                       |
|-----------------------------------|---------------------------|-----------------------------|------------------------------|-----------------------|
|                                   | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| States and political subdivisions | \$ 11,699                 | \$ 223                      | \$                           | \$ 11,922             |
| Mortgage-backed securities        | 1                         |                             |                              | 1                     |
| Other securities                  | 375                       |                             |                              | 375                   |
| <b>Total</b>                      | <b>\$ 12,075</b>          | <b>\$ 223</b>               | <b>\$</b>                    | <b>\$ 12,298</b>      |

The following table reflects those investments in an unrealized loss position at June 30, 2008, and December 31, 2007. The Company has the intent and ability to hold until maturity or recovery any security in a continuous unrealized loss position for 12 or more months.

| <b>Description of Securities</b><br><i>(In Thousands)</i> | <b>June 30, 2008</b>       |                              |                            |                              | <b>Total</b>          |                              |
|---|----------------------------|------------------------------|----------------------------|------------------------------|-----------------------|------------------------------|
|   | <b>Less than 12 Months</b> |                              | <b>12 Months or longer</b> |                              |                       |                              |
|   | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| U. S. Government agency securities                        | \$                         | \$                           | \$                         | \$                           | \$                    | \$                           |
| States and political subdivisions                         | 84,832                     | (2,262)                      | 16,433                     | (1,522)                      | 101,265               | (3,784)                      |
| Trust-preferred securities                                | 77,691                     | (24,216)                     | 45,876                     | (16,579)                     | 123,567               | (40,795)                     |
| Mortgage-backed securities                                | 140,077                    | (1,903)                      | 24,005                     | (3,877)                      | 164,082               | (5,780)                      |
| Equity securities   | 2,688                      | (490)                        | 2,168                      | (202)                        | 4,856                 | (692)                        |
| <b>Total</b>  | <b>\$ 305,288</b>          | <b>\$ (28,871)</b>           | <b>\$ 88,482</b>           | <b>\$ (22,180)</b>           | <b>\$ 393,770</b>     | <b>\$ (51,051)</b>           |

| <b>Description of Securities</b>   | <b>December 31, 2007</b>   |                              |                            |                              | <b>Total</b>          |                              |
|------------------------------------|----------------------------|------------------------------|----------------------------|------------------------------|-----------------------|------------------------------|
|                                    | <b>Less than 12 Months</b> |                              | <b>12 Months or longer</b> |                              |                       |                              |
|                                    | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| U. S. Government agency securities | \$                         | \$                           | \$                         | \$                           | \$                    | \$                           |
| States and political subdivisions  | 40,461                     | (900)                        | 12,287                     | (65)                         | 52,748                | (965)                        |
| Trust-preferred securities         | 129,006                    | (12,431)                     | 21,994                     | (1,675)                      | 151,000               | (14,106)                     |

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|                            |            |             |           |            |            |             |
|----------------------------|------------|-------------|-----------|------------|------------|-------------|
| Mortgage-backed securities | 7,991      | (108)       | 63,393    | (1,965)    | 71,384     | (2,073)     |
| Equity securities          | 2,269      | (345)       | 1,759     | (71)       | 4,028      | (416)       |
| Total                      | \$ 179,727 | \$ (13,784) | \$ 99,433 | \$ (3,776) | \$ 279,160 | \$ (17,560) |

At June 30, 2008, there were 317 individual security holdings in an unrealized loss position. 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, changes in market credit risk premiums, and current market illiquidity.

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The Company has a portfolio of trust-preferred securities with a total market value of approximately \$123.57 million as of June 30, 2008. That portfolio is comprised of single-issue securities and pooled trust-preferred securities. The single-issue securities are trust-preferred issuances from some of the largest banks in the nation and had a total market value of approximately \$44.48 million as of June 30, 2008, compared with their adjusted cost basis of approximately \$55.44 million.

At June 30, 2008, the total market value of the pooled trust-preferred securities was approximately \$79.09 million, compared with an adjusted cost basis of approximately \$108.93 million. The collateral underlying these securities is comprised of 86% of bank trust-preferred securities and subordinated debt issuances. The remaining collateral is from REITs and insurance companies. All of the pooled trust-preferred securities are A-rated, have not been subject to a credit rating downgrade, and have not deferred an interest payment. Certain of these securities are, however, on negative watch by one or more rating firms. The securities carry variable rate structures that float at a prescribed margin over 3-month LIBOR. The Company has modeled the expected cash flows from the pooled trust-preferred securities and at present does not expect to have an adverse cash flow effect under any of the scenarios modeled due to the existence of other subordinate classes within the pools.

Although the Company has both the intent and ability to hold the securities to maturity, the Company is closely monitoring this portfolio due to the substantial market discounts. The market discounts are due to credit market disruption in bank subordinated debt instruments and the possibility of future negative credit events within the banking sector, which could affect collateral within certain of the pools and single-issue securities.

**Note 4. Loans**

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

|                               | <b>June 30, 2008</b> |                | <b>December 31, 2007</b> |                |
|-------------------------------|----------------------|----------------|--------------------------|----------------|
|                               | <b>Amount</b>        | <b>Percent</b> | <b>Amount</b>            | <b>Percent</b> |
| <i>(Dollars in Thousands)</i> |                      |                |                          |                |
| Loans held for investment:    |                      |                |                          |                |
| Commercial and agricultural   | \$ 85,833            | 7.27%          | \$ 96,261                | 7.85%          |
| Commercial real estate        | 385,870              | 32.67%         | 386,112                  | 31.51%         |
| Residential real estate       | 490,519              | 41.53%         | 498,345                  | 40.66%         |
| Construction                  | 144,094              | 12.20%         | 163,310                  | 13.33%         |
| Consumer                      | 67,572               | 5.72%          | 75,447                   | 6.16%          |
| Other                         | 7,219                | 0.61%          | 6,027                    | 0.49%          |
| <b>Total</b>                  | <b>\$ 1,181,107</b>  | <b>100.00%</b> | <b>\$ 1,225,502</b>      | <b>100.00%</b> |
| Loans held for sale           | \$ 1,522             |                | \$ 811                   |                |

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 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.

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Financial instruments whose contract amounts represent credit risk are commitments to extend credit (including availability of lines of credit) of \$207.61 million and standby letters of credit and financial guarantees written of \$3.07 million at June 30, 2008. Additionally, the Company had gross notional amount of outstanding commitments to lend related to secondary market mortgage loans of \$7.20 million at June 30, 2008.

**Note 5. Allowance for Loan Losses**

There was significant disruption and volatility in the financial and capital markets during the second half of 2007 and the first half of 2008. Turmoil in the mortgage market adversely impacted both domestic and global markets, and led to a significant credit and liquidity crisis. The disruption has been exacerbated by significant declines in valuations within the real estate and housing markets. Decreases in real estate values could adversely affect the value of property used as collateral for loans, including loans originated by the Company. Adverse changes in the economy may have a negative effect on the ability of the Company's borrowers to make timely loan payments, which would have an adverse impact on the Company's earnings. A further increase in loan delinquencies could adversely impact loan loss experience, causing potential increases in the provision and 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, 2008 and 2007.

| <i>(In Thousands)</i>     | <b>For the Three Months<br/>Ended<br/>June 30,</b> |             | <b>For the Six Months<br/>Ended<br/>June 30,</b> |             |
|---------------------------|--|-------------|--|-------------|
|                           | <b>2008</b>  | <b>2007</b> | <b>2008</b>                                      | <b>2007</b> |
| Beginning balance         | \$ 12,862  | \$ 14,510   | \$ 12,833  | \$ 14,549   |
| Provision for loan losses | 937  |             | 1,260  |             |
| Charge-offs               | (1,198)  | (911)       | (2,164)  | (1,804)     |
| Recoveries                | 832  | 335         | 1,504  | 1,189       |
| Ending balance            | \$ 13,433  | \$ 13,934   | \$ 13,433  | \$ 13,934   |

**Table of Contents****Note 6. Deposits**

The following is a summary of interest-bearing deposits by type as of June 30, 2008, and December 31, 2007.

| <i>(In Thousands)</i>            | <b>June 30<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|----------------------------------|-------------------------|----------------------------------|
| Interest-bearing demand deposits | \$ 172,623              | \$ 153,570                       |
| Savings deposits                 | 312,148                 | 327,691                          |
| Certificates of deposit          | 629,920                 | 688,095                          |
| Total                            | \$ 1,114,691            | \$ 1,169,356                     |

**Note 7. Borrowings**

The following schedule details the Company's Federal Home Loan Bank ( FHLB ) borrowings and other indebtedness at June 30, 2008, and December 31, 2007.

| <i>(In thousands)</i> | <b>June 30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|-----------------------|--------------------------|----------------------------------|
| FHLB borrowings       | \$ 200,852               | \$ 275,888                       |
| Subordinated debt     | 15,464                   | 15,464                           |
| Other long-term debt  | 546                      | 564                              |
| Total                 | \$ 216,862               | \$ 291,916                       |

FHLB borrowings include \$200.00 million in convertible and callable advances and \$852 thousand of noncallable term advances from the FHLB at June 30, 2008. The weighted average interest rates of advances are 3.22% and 4.38% at June 30, 2008, and December 31, 2007, 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 \$50.00 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 3.73% at June 30, 2008. The fair value of the interest rate swap was a liability of \$1.34 million at June 30, 2008.

At June 30, 2008, the FHLB advances have maturities between five and thirteen years. The scheduled maturities of the advances are as follows:

| <i>(In Thousands)</i> | <b>Amount</b> |
|-----------------------|---------------|
| 2008                  | \$            |
| 2009                  |               |
| 2010                  |               |
| 2011                  |               |
| 2012                  |               |
| 2013 and thereafter   | 200,852       |
| Total                 | \$ 200,852    |

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.

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Also included in other indebtedness is \$15.46 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 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 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 and loss. The following table summarizes the components of comprehensive income and loss.

| <i>(In Thousands)</i>   | For the Three Months<br>Ended<br>June 30, |          | For the Six Months<br>Ended<br>June 30, |           |
|---|---|----------|---|-----------|
|   | 2008                                      | 2007     | 2008                                    | 2007      |
| Net income  | \$ 6,238                                  | \$ 7,439 | \$ 12,550                               | \$ 14,563 |
| Other comprehensive income  |   |          |   |           |
| Unrealized loss on securities available-for-sale                      | (22,138)                                  | (8,453)  | (36,052)                                | (7,668)   |
| Reclassification adjustment for losses (gains) realized in net income | (460)                                     | 14       | (1,350)                                 | (79)      |
| Unrealized (loss) gain on derivative securities                       | 1,562                                     | 727      | (22)                                    | 475       |
| Income tax effect   | 8,415                                     | 3,086    | 14,969                                  | 2,909     |
| Total other comprehensive loss  | (12,622)                                  | (4,626)  | (22,454)                                | (4,363)   |
| Comprehensive (loss) income   | \$ (6,384)                                | \$ 2,813 | \$ (9,904)                              | \$ 10,200 |

**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.

**Note 10. Segment Information**

The Company operates in two segments: Community Banking and Insurance Services. The Community Banking segment includes both commercial and consumer lending and provides customers with such products as commercial loans, real estate loans, business financing and consumer loans. This segment provides customers with several choices of deposit products including demand deposit accounts, savings accounts and certificates of deposit. In addition, the Community Banking segment provides wealth management services to a broad range of customers. The Insurance Services segment is a full-service insurance agency providing commercial and personal lines of insurance.

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The following table sets forth information about the reportable operating segments and reconciliation of this information to the consolidated financial statements at and for the three- and six-month periods ended June 30, 2008.

| <i>(In Thousands)</i>                | <b>For the Three Months Ended<br/>June 30, 2008</b> |                               |                                | <b>Total</b> |
|--------------------------------------|---|-------------------------------|--------------------------------|--------------|
|                                      | <b>Community<br/>Banking</b>                        | <b>Insurance<br/>Services</b> | <b>Parent/<br/>Elimination</b> |              |
| Net interest income                  | \$ 16,840   | \$ (5)                        | \$ (210)                       | \$ 16,625    |
| Provision for loan losses            | 937   |                               |                                | 937          |
| Noninterest income                   | 6,644   | 1,146                         | (66)                           | 7,724        |
| Noninterest expense                  | 14,046  | 991                           | (278)                          | 14,759       |
| Income before income taxes           | 8,501   | 150                           | 2                              | 8,653        |
| Provision (benefit) for income taxes | 2,369   | 44                            | 2                              | 2,415        |
| Net income                           | \$ 6,132  | \$ 106                        | \$                             | \$ 6,238     |

| <i>(In Thousands)</i>                | <b>For the Six Months Ended<br/>June 30, 2008</b> |                               |                                | <b>Total</b> |
|--------------------------------------|---|-------------------------------|--------------------------------|--------------|
|                                      | <b>Community<br/>Banking</b>                      | <b>Insurance<br/>Services</b> | <b>Parent/<br/>Elimination</b> |              |
| Net interest income                  | \$ 33,475   | \$ (11)                       | \$ (479)                       | \$ 32,985    |
| Provision for loan losses            | 1,260   |                               |                                | 1,260        |
| Noninterest income                   | 14,638  | 2,490                         | (263)                          | 16,865       |
| Noninterest expense                  | 29,838  | 2,037                         | (833)                          | 31,042       |
| Income before income taxes           | 17,015  | 442                           | 91                             | 17,548       |
| Provision (benefit) for income taxes | 4,801   | 130                           | 67                             | 4,998        |
| Net income                           | \$ 12,214   | \$ 312                        | \$ 24                          | \$ 12,550    |
| End of period assets                 | \$ 2,034,670                                      | \$ 9,067                      | \$ 9,950                       | \$ 2,053,687 |

**Note 11: Fair Value Disclosures**

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, Fair Value Measurements, ( SFAS 157 ) for financial assets and financial liabilities. In accordance with Financial Accounting Standards Board Staff Position (FSP) No. 157-2, Effective Date of FASB Statement No. 157, the Company will delay application of SFAS 157 for non-financial assets and non-financial liabilities until January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal, or most advantageous, market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii)

knowledgeable, (iii) able to transact, and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset, or the replacement cost. Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market

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participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, such as interest rates, volatilities, prepayment speeds, and credit risks, or inputs that are derived principally from or corroborated by market data by correlation or other means.
- Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value effective January 1, 2008.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon third party models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

*Securities Available-for-Sale.* Securities classified as available-for-sale are reported at fair value utilizing Level 1 and Level 2 inputs. For Level 1 securities, the Company obtains fair value measurements from active exchanges. For Level 2 securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things.

*Other Assets and Associated Liabilities.* Securities held for trading purposes are recorded at fair value and included in other assets on the consolidated balance sheets. Securities held for trading purposes include assets related to employee deferred compensation plans. The assets associated with these plans are generally invested in equities and classified as Level 1. Deferred compensation liabilities, also classified as Level 1, are carried at the fair value of the obligation to the employee, which corresponds to the fair value of the invested assets.

*Derivatives.* Derivatives are reported at fair value utilizing Level 2 inputs. The Company obtains dealer quotations based on observable data to value its derivatives.

*Impaired Loans.* Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria.

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The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| <i>(In Thousands)</i>         | Fair Value Measurements Using |           |         | Total      |
|-------------------------------|-------------------------------|-----------|---------|------------|
|                               | Level 1                       | Level 2   | Level 3 | Fair Value |
| Available-for-sale securities | \$6,661                       | \$591,777 | \$      | \$598,438  |
| Other assets                  | 2,913                         |           |         | 2,913      |
| Derivative assets             |                               | 537       |         | 537        |
| Other liabilities             | 2,913                         |           |         | 2,913      |
| Derivative liabilities        |                               | 1,976     |         | 1,976      |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances, for example, when there is evidence of impairment. The fair value of loans considered impaired and collateral dependent was \$3.30 million at June 30, 2008.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. As stated above, SFAS 157 will be applicable to these fair value measurements beginning January 1, 2009.

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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 2007 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 \$2.05 billion at June 30, 2008. 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 over fifty locations in Virginia, West Virginia, North and South Carolina, and Tennessee. The Company is also the parent of GreenPoint Insurance Group, Inc., a North Carolina-based full-service insurance agency offering commercial and personal lines (GreenPoint). The Bank is the parent of Investment Planning Consultants, Inc. (IPC), 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 2007 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 is not available, valuation adjustments are estimated by management primarily through the use of internal modeling techniques and appraisal estimates.

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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 2007 Annual Report on Form 10-K. There have been no material changes in the Company's critical accounting policies since December 31, 2007.

**COMPANY OVERVIEW**

The Company is a financial holding company which operates within the five-state region of Virginia, West Virginia, North and South Carolina, and Tennessee. The Company operates through the Bank, IPC, and GreenPoint to offer a wide range of financial services. The Company reported total assets of \$2.05 billion at June 30, 2008.

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 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 the Bank's Trust and Financial Services Division ( Trust Division ) and its registered investment advisory firm, IPC. The Bank's Trust Division and IPC manage assets with an aggregate market value of \$831 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 July 2008, the Company announced its proposed acquisition of Coddle Creek Financial Corp. ( Coddle Creek ) headquartered in Mooresville, North Carolina. Coddle Creek is the bank holding company for Mooresville Savings Bank, SSB ( Mooresville Savings ), a state-chartered savings bank providing deposit and loan services in Mooresville, Huntersville, and Cornelius, North Carolina (the Lake Norman region just north of Charlotte, North Carolina). At June 30, 2008, Coddle Creek had total assets of \$158.60 million, loans of \$133.71 million, deposits of \$136.97 million and stockholders' equity of \$19.09 million.

Pursuant to the terms of the definitive merger agreement, Coddle Creek will merge with and into the Company. Immediately thereafter, Mooresville Savings will be merged with and into the Bank and operate under the name, identity, and branch network of First Community Bank, N.A. Stockholders of Coddle Creek will receive merger consideration of \$19.60 per share and 0.9046 shares of the Company's common stock for each outstanding share of Coddle Creek common stock. The merger transaction is valued at approximately \$33.01 million, based on the Company's closing price of \$35.83 on July 31, 2008. The value of the transaction and value of each share of Coddle Creek common stock on consummation of the merger may be higher or lower depending on the value of the Company's common stock on such date. The merger is expected to be completed in the fourth quarter of 2008, subject to regulatory approvals and approval by the stockholders of Coddle Creek.

The proposed acquisition of Mooresville Savings represents the Company's continued expansion into targeted suburban markets as part of its strategic plan for growth of the franchise in desirable markets in and near important MSA's in the Mid-Atlantic and Southeast United States. The Company expects to substantially expand customer offerings, support technologies, and delivery channels to enhance the existing core business of Mooresville Savings. In September 2007, the Company acquired GreenPoint, a High Point, North Carolina, insurance agency. In connection with the initial payment of approximately \$1.66 million, the Company issued 49,088 shares of its common stock. Under the terms of the stock purchase agreement, former shareholders of GreenPoint are entitled to additional consideration aggregating up to \$1.45 million in the form of cash or the Company's common stock, valued at the time

of issuance, if certain future operating

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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. The Company assumed \$5.57 million debt in connection with the acquisition, of which approximately \$5.00 million was retired at closing. In March 2008, the Company issued 7,728 additional shares in connection with the acquisition, resulting in a goodwill adjustment of approximately \$267 thousand. The acquisition of GreenPoint has added a total of \$9.09 million of goodwill and intangibles.

The Company opened a new branch location in Summersville, West Virginia, in May 2008. In December 2007, the Company opened two new locations in the Richmond, Virginia, area. In November and October 2007, the Company opened a new branch location in Princeton and Daniels, West Virginia, respectively. In March 2007, the Company opened two new branch locations in the Winston-Salem, North Carolina, area.

**RESULTS OF OPERATIONS****Overview**

Net income for the three months ended June 30, 2008, was \$6.24 million, or \$0.57 per basic share and \$0.56 per diluted share, compared with \$7.44 million, or \$0.66 per basic and diluted share, for the three months ended June 30, 2007, a decrease of \$1.20 million, or 16.14%. Return on average assets was 1.23% for the three months ended June 30, 2008, compared with 1.40% for the same period in 2007. Return on average equity for the three months ended June 30, 2008, was 12.08% compared with 13.56% for the three months ended June 30, 2007.

Net income for the six months ended June 30, 2008, was \$12.55 million, or \$1.14 per basic share and \$1.13 per diluted share, compared with \$14.56 million, or \$1.29 per basic share and \$1.28 per diluted share, for the six months ended June 30, 2007, a decrease of \$2.01 million, or 13.82%. Return on average assets was 1.22% for the six months ended June 30, 2008, compared with 1.41% for the same period in 2007. Return on average equity for the six months ended June 30, 2008, was 11.87% compared with 13.45% for the six months ended June 30, 2007.

**Net Interest Income Quarterly Comparison (See Table I)**

Net interest income, the largest contributor to earnings, was \$16.63 million for the three months ended June 30, 2008, compared with \$17.01 million for the corresponding period in 2007, a decrease of \$389 thousand, or 2.29%.

Tax-equivalent net interest income totaled \$17.73 million for the three months ended June 30, 2008, a decrease of \$460 thousand from \$18.19 million for the second quarter of 2007. The decrease in net interest income was due primarily to decreases in loan balances and in loan yields as a result of the precipitous declines in the prime rate and the target lending rates for banks during the last nine months.

Compared with the second quarter of 2007, average earning assets decreased \$113.93 million while interest-bearing liabilities increased \$60.31 million during the three months ended June 30, 2008. The yield on average earning assets decreased by 58 basis points to 6.31% from 6.89% between the three months ended June 30, 2008 and 2007, respectively. Total cost of interest-bearing liabilities decreased 89 basis points between the second quarters of 2007 and 2008, which resulted in a net interest rate spread that was 31 basis points higher at 3.59% for the second quarter of 2008 compared with 3.28% for the same period last year. The Company's tax-equivalent net interest margin of 3.92% for the three months ended June 30, 2008, increased 14 basis points from 3.78% for the same period of 2007.

The rate earned on loans decreased 71 basis points to 6.78% from 7.49% for the three months ended June 30, 2008 and 2007, respectively. The effect of the cuts in the target federal funds rate by the Federal Open Market Committee and the associated decline in the Prime rate had a profound impact on loan yields throughout 2008. Declines in the average portfolio balances also contributed to a net decrease of \$3.51 million, or 14.97%, in tax-equivalent loan interest income for the second quarter of 2008 compared with the second quarter of 2007.

During the three months ended June 30, 2008, the tax-equivalent yield on available-for-sale securities decreased 31 basis points to 5.44%, while the average balance decreased by \$16.62 million, or 2.64%, compared with the same period in 2007. The average tax-equivalent yield decreased due to the large portion of variable rate securities in the portfolio. The average balance of the held-to-maturity securities portfolio continued to decline as securities matured or were called and were not replaced.

Compared with the second quarter of 2007, average interest-bearing balances with banks decreased to \$13.17 million during the second quarter of 2008, as the yield decreased 273 basis points to 2.17% during the same period.

Interest-bearing balances with banks is comprised largely of excess liquidity bearing overnight market rates. The rate

earned on these overnight balances during the second quarter of 2008 decreased along with decreases in short-term benchmark interest rates.

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Compared with the same period in 2007, the average balances of interest-bearing demand deposits increased \$26.53 million, or 17.98%, while the average rate paid during the second quarter of 2008 decreased by 17 basis points. During the three months ended June 30, 2008, the average balances of savings deposits decreased \$16.42 million, or 5.05%, while the average rate paid decreased 64 basis points compared to the same period in 2007. Average time deposits decreased \$64.38 million, or 9.14%, while the average rate paid on time deposits decreased 79 basis points from 4.47% in the second quarter of 2007 to 3.68% in the second quarter of 2008. Retail repurchase agreements, which consist of collateralized retail deposits and commercial treasury accounts, decreased \$12.41 million, or 7.47%, to \$153.77 million for the three months ended June 30, 2008, while the rate decreased 151 basis points to 2.06% during the same period. The level of average non-interest-bearing demand deposits decreased \$16.83 million, or 7.18%, to \$217.70 million during the quarter ended June 30, 2008, compared with the corresponding period of the prior year.

Compared with the same period in 2007, average federal funds purchased decreased \$2.74 million to \$9.93 million during the second quarter of 2008, and wholesale repurchase agreements remained unchanged at \$50.00 million, while the rate decreased 269 basis points between the two periods. The average balance of FHLB borrowings and other long-term debt increased by \$9.11 million, or 3.56%, in the second quarter of 2008 to \$264.66 million, while the rate paid on those borrowings decreased 74 basis points. The Company prepaid a \$25.00 million FHLB advance during the first quarter of 2008. The advance carried an interest rate of 5.47% and was extinguished using current liquidity sources. A \$50.00 million advance paying 3.64% was also called in June 2008.

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

Net interest income was \$32.99 million for the six months ended June 30, 2008, compared with \$34.03 million for the corresponding period in 2007, a decrease of \$1.04 million, or 3.07%. Tax-equivalent net interest income totaled \$35.22 million for the six months ended June 30, 2008, a decrease of \$1.03 million from \$36.24 million for the first half of 2007. The decrease in net interest income was due primarily to decreases in loan balances and in loan yields as a result of the precipitous declines in the prime rate and the target lending rates for banks during the last nine months. Compared with the first half of 2007, average earning assets decreased \$46.11 million while interest-bearing liabilities increased \$3.76 million during the six months ended June 30, 2008. The yield on average earning assets decreased by 47 basis points to 6.47% from 6.94% between the six months ended June 30, 2008 and 2007, respectively. Total cost of interest-bearing liabilities decreased 59 basis points between the first halves of 2007 and 2008, which resulted in a net interest rate spread that was 12 basis points higher at 3.49% for the first half of 2008 compared with 3.37% for the same period last year. The Company's tax-equivalent net interest margin of 3.85% for the six months ended June 30, 2008, decreased two basis points from 3.87% for the same period of 2007.

The rate earned on loans decreased 58 basis points to 6.94% from 7.52% for the six months ended June 30, 2008 and 2007, respectively. The effect of the cuts in the target federal funds rate by the Federal Open Market Committee and the associated decline in the Prime rate had a profound impact on loan yields in the first half of 2008. Declines in the average portfolio balances also contributed to a net decrease of \$5.78 million, or 12.31%, in tax-equivalent loan interest income for the first half of 2008 compared with the first half of 2007.

During the six months ended June 30, 2008, the tax-equivalent yield on available-for-sale securities decreased 12 basis points to 5.62%, while the average balance increased by \$36.75 million, or 6.32%, compared with the same period in 2007. The average tax-equivalent yield decreased due to the large portion of variable-rate securities in the portfolio. The average balance of the held-to-maturity securities portfolio continued to decline as securities matured or were called and were not replaced.

Compared with the first half of 2007, average interest-bearing balances with banks decreased to \$17.89 million during the first half of 2008, as the yield decreased 203 basis points to 2.82% during the same period. Interest-bearing balances with banks is comprised largely of excess liquidity bearing overnight market rates. The rate earned on these overnight balances during the first half of 2008 decreased along with decreases in short-term benchmark interest rates. Compared with the same period in 2007, the average balances of interest-bearing demand deposits increased \$21.37 million, or 14.56%, while the average rate paid during the first half of 2008 decreased 14 basis points. During the six months ended June 30, 2008, average savings deposits decreased \$4.52 million, or 1.40%, while the rate paid was 1.69%, a 47 basis point decrease from the first half of 2007. Average time deposits decreased \$44.44 million, or

6.34%, while the average rate paid on time deposits decreased 42 basis points from 4.42% in the first half of 2007 to 4.00% in the first half of 2008. Retail

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repurchase agreements, which consist of collateralized retail deposits and commercial treasury accounts, decreased \$12.19 million, or 7.44%, to \$151.68 million for the six months ended June 30, 2008, while the rate decreased 120 basis points to 2.40% during the same period. The level of average non-interest-bearing demand deposits decreased \$16.73 million, or 7.21%, to \$215.34 million during the half ended June 30, 2008, compared with the corresponding period of the prior year.

Compared with the same period in 2007, average federal funds purchased decreased \$1.96 million to \$5.88 million during the first half of 2008, and wholesale repurchase agreements remained unchanged at \$50.00 million, while the rate decreased 166 basis points between the two periods. The average balance of FHLB borrowings and other long-term debt increased by \$45.50 million, or 20.22%, in the first half of 2008 to \$270.58 million, while the rate paid on those borrowings decreased 66 basis points. The Company prepaid a \$25.00 million FHLB advance during the first half of 2008. The advance carried an interest rate of 5.47% and was extinguished using current liquidity. A \$50.00 million advance paying 3.64% was also called in June 2008.

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

|  | Three Months Ended<br>June 30, 2008 |                 |                       | Three Months Ended<br>June 30, 2007 |                 |                       |
|--|-------------------------------------|-----------------|-----------------------|-------------------------------------|-----------------|-----------------------|
|  | Average<br>Balance                  | Interest<br>(1) | Yield/<br>Rate<br>(1) | Average<br>Balance                  | Interest<br>(1) | Yield/<br>Rate<br>(1) |
| <i>(Dollars in Thousands)</i>          |                                     |                 |                       |                                     |                 |                       |
| <b>ASSETS</b>                          |                                     |                 |                       |                                     |                 |                       |
| Earning Assets                         |                                     |                 |                       |                                     |                 |                       |
| Loans (2)                              | \$ 1,180,813                        | \$ 19,912       | 6.78%                 | \$ 1,253,679                        | \$ 23,417       | 7.49%                 |
| Securities available for sale          | 612,411                             | 8,278           | 5.44%                 | 629,030                             | 9,017           | 5.75%                 |
| Securities held to maturity            | 10,927                              | 273             | 10.05%                | 16,236                              | 322             | 7.98%                 |
| Interest-bearing deposits              | 13,171                              | 71              | 2.17%                 | 32,302                              | 395             | 4.90%                 |
| Total Earning Assets                   | 1,817,322                           | 28,534          | 6.31%                 | 1,931,247                           | 33,151          | 6.89%                 |
| Other assets                           | 228,451                             |                 |                       | 203,365                             |                 |                       |
| <b>TOTAL ASSETS</b>                    | <b>\$ 2,045,773</b>                 |                 |                       | <b>\$ 2,134,612</b>                 |                 |                       |
| <b>LIABILITIES</b>                     |                                     |                 |                       |                                     |                 |                       |
| Interest-bearing deposits:             |                                     |                 |                       |                                     |                 |                       |
| Demand deposits                        | \$ 174,100                          | \$ 65           | 0.15%                 | \$ 147,570                          | \$ 118          | 0.32%                 |
| Savings deposits                       | 308,344                             | 1,188           | 1.55%                 | 324,759                             | 1,776           | 2.19%                 |
| Time deposits                          | 640,236                             | 5,865           | 3.68%                 | 704,611                             | 7,854           | 4.47%                 |
| Total interest-bearing deposits        | 1,122,680                           | 7,118           | 2.55%                 | 1,176,940                           | 9,748           | 3.32%                 |
| Borrowings:                            |                                     |                 |                       |                                     |                 |                       |
| Federal funds purchased                | 9,932                               | 60              | 2.43%                 | 12,676                              | 177             | 5.60%                 |
| Retail repurchase agreements           | 153,768                             | 789             | 2.06%                 | 166,180                             | 1,479           | 3.57%                 |
| Wholesale repurchase agreements        | 50,000                              | 214             | 1.72%                 | 50,000                              | 550             | 4.41%                 |
| FHLB borrowings and other indebtedness | 264,661                             | 2,627           | 3.99%                 | 255,554                             | 3,011           | 4.73%                 |
| Total borrowings                       | 478,361                             | 3,690           | 3.10%                 | 484,410                             | 5,217           | 4.32%                 |
| Total interest-bearing liabilities     | 1,601,041                           | 10,808          | 2.72%                 | 1,661,350                           | 14,965          | 3.61%                 |
| Non-interestbearing                    |                                     |                 |                       |                                     |                 |                       |
| demand deposits                        | 217,704                             |                 |                       | 234,536                             |                 |                       |
| Other liabilities                      | 19,368                              |                 |                       | 18,737                              |                 |                       |
| Stockholders Equity                    | 207,660                             |                 |                       | 219,989                             |                 |                       |



|   |              |              |       |
|---|--------------|--------------|-------|
| TOTAL LIABILITIES<br>AND STOCKHOLDERS<br>EQUITY | \$ 2,045,773 | \$ 2,134,612 |       |
| Net Interest Income, Tax<br>Equivalent          | \$ 17,726    | \$ 18,186    |       |
| Net Interest Rate Spread<br>(3)                 |              | 3.59%        | 3.28% |
| Net Interest Margin (4)                         |              | 3.92%        | 3.78% |

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

|  | Six Months Ended<br>June 30, 2008 |                 |                       | Six Months Ended<br>June 30, 2007 |                 |                       |
|--|-----------------------------------|-----------------|-----------------------|-----------------------------------|-----------------|-----------------------|
|  | Average<br>Balance                | Interest<br>(1) | Yield/<br>Rate<br>(1) | Average<br>Balance                | Interest<br>(1) | Yield/<br>Rate<br>(1) |
| <i>(Dollars in Thousands)</i>          |                                   |                 |                       |                                   |                 |                       |
| <b>ASSETS</b>                          |                                   |                 |                       |                                   |                 |                       |
| Earning Assets                         |                                   |                 |                       |                                   |                 |                       |
| Loans (2)                              | \$ 1,193,147                      | \$ 41,169       | 6.94%                 | \$ 1,259,620                      | \$ 46,948       | 7.52%                 |
| Securities available for sale          | 617,843                           | 17,276          | 5.62%                 | 581,091                           | 16,552          | 5.74%                 |
| Securities held to maturity            | 11,501                            | 515             | 9.00%                 | 17,991                            | 711             | 7.97%                 |
| Interest-bearing deposits              | 17,887                            | 251             | 2.82%                 | 27,788                            | 669             | 4.85%                 |
| Total Earning Assets                   | 1,840,378                         | 59,211          | 6.47%                 | 1,886,490                         | 64,880          | 6.94%                 |
| Other assets                           | 228,202                           |                 |                       | 199,588                           |                 |                       |
| <b>TOTAL ASSETS</b>                    | <b>\$ 2,068,580</b>               |                 |                       | <b>\$ 2,086,078</b>               |                 |                       |
| <b>LIABILITIES</b>                     |                                   |                 |                       |                                   |                 |                       |
| Interest-bearing deposits:             |                                   |                 |                       |                                   |                 |                       |
| Demand deposits                        | \$ 168,138                        | \$ 140          | 0.17%                 | \$ 146,770                        | \$ 229          | 0.31%                 |
| Savings deposits                       | 317,702                           | 2,675           | 1.69%                 | 322,223                           | 3,449           | 2.16%                 |
| Time deposits                          | 656,440                           | 13,044          | 4.00%                 | 700,884                           | 15,370          | 4.42%                 |
| Total interest-bearing deposits        | 1,142,280                         | 15,859          | 2.79%                 | 1,169,877                         | 19,048          | 3.28%                 |
| Borrowings:                            |                                   |                 |                       |                                   |                 |                       |
| Federal funds purchased                | 5,875                             | 79              | 2.70%                 | 7,833                             | 219             | 5.64%                 |
| Retail repurchase agreements           | 151,675                           | 1,809           | 2.40%                 | 163,862                           | 2,926           | 3.60%                 |
| Wholesale repurchase agreements        | 50,000                            | 687             | 2.76%                 | 50,000                            | 1,096           | 4.42%                 |
| FHLB borrowings and other indebtedness | 270,583                           | 5,561           | 4.13%                 | 225,082                           | 5,347           | 4.79%                 |
| Total borrowings                       | 478,133                           | 8,136           | 3.42%                 | 446,777                           | 9,588           | 4.33%                 |
| Total interest-bearing liabilities     | 1,620,413                         | 23,995          | 2.98%                 | 1,616,654                         | 28,636          | 3.57%                 |
| Non-interestbearing                    |                                   |                 |                       |                                   |                 |                       |
| demand deposits                        | 215,338                           |                 |                       | 232,069                           |                 |                       |
| Other liabilities                      | 20,159                            |                 |                       | 18,949                            |                 |                       |
| Stockholders Equity                    | 212,670                           |                 |                       | 218,406                           |                 |                       |

|   |              |              |       |
|---|--------------|--------------|-------|
| TOTAL LIABILITIES<br>AND STOCKHOLDERS<br>EQUITY | \$ 2,068,580 | \$ 2,086,078 |       |
| Net Interest Income, Tax<br>Equivalent          | \$ 35,216    | \$ 36,244    |       |
| Net Interest Rate Spread<br>(3)                 |              | 3.49%        | 3.37% |
| Net Interest Margin (4)                         |              | 3.85%        | 3.87% |

(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>                            | <b>Three Months Ended<br/>June 30, 2008<br/>Compared to 2007</b> |             |              | <b>Six Months Ended<br/>June 30, 2008<br/>Compared to 2007</b> |             |              |
|--|--|-------------|--------------|--|-------------|--------------|
|  | <b>\$ Increase/(Decrease) due to</b>                             |             |              | <b>\$ Increase/(Decrease) due to</b>                           |             |              |
|  | <b>Volume</b>  | <b>Rate</b> | <b>Total</b> | <b>Volume</b>  | <b>Rate</b> | <b>Total</b> |
| Interest Earned On:                              |  |             |              |  |             |              |
| Loans (1)  | \$ (1,333)   | \$ (2,172)  | \$ (3,505)   | \$ (2,353)   | \$ (3,426)  | \$ (5,779)   |
| Securities available-for-sale<br>(1)             | (241)  | (498)       | (739)        | 1,086  | (362)       | 724          |
| Securities held-to-maturity (1)                  | (251)  | 202         | (49)         | (306)  | 110         | (196)        |
| Interest-bearing deposits with<br>other banks    | (167)  | (157)       | (324)        | (193)  | (225)       | (418)        |
| Total interest-earning assets                    | (1,992)  | (2,625)     | (4,617)      | (1,766)  | (3,903)     | (5,669)      |
| Interest Paid On:                                |  |             |              |  |             |              |
| Demand deposits                                  | 27   | (80)        | (53)         | 40   | (129)       | (89)         |
| Savings deposits                                 | (86)   | (502)       | (588)        | (47)   | (727)       | (774)        |
| Time deposits                                    | (680)  | (1,309)     | (1,989)      | (923)  | (1,403)     | (2,326)      |
| Fed funds purchased                              | (32)   | (85)        | (117)        | (45)   | (95)        | (140)        |
| Retail repurchase agreements                     | (104)  | (586)       | (690)        | (203)  | (914)       | (1,117)      |
| Wholesale repurchase<br>agreements               |  | (336)       | (336)        |  | (409)       | (409)        |
| FHLB borrowings and other<br>long-term debt      | 114  | (498)       | (384)        | 667  | (453)       | 214          |
| Total interest-bearing<br>liabilities            | (761)  | (3,396)     | (4,157)      | (511)  | (4,130)     | (4,641)      |
| Change in net interest income,<br>tax-equivalent | \$ (1,231)   | \$ 771      | \$ (460)     | \$ (1,255)   | \$ 227      | \$ (1,028)   |

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

**Provision and Allowance for Loan Losses**

The allowance for loan losses was \$13.43 million at June 30, 2008, \$12.83 million at December 31, 2007 and \$13.93 million at June 30, 2007. The Company's allowance for loan loss activity for the three- and six-month periods ended June 30, 2008 and 2007, is as follows:

**For the Three Months  
Ended**

**For the Six Months  
Ended**

| <i>(In Thousands)</i>            | <b>June 30,</b> |             | <b>June 30,</b> |             |
|----------------------------------|-----------------|-------------|-----------------|-------------|
|                                  | <b>2008</b>     | <b>2007</b> | <b>2008</b>     | <b>2007</b> |
| <b>Allowance for loan losses</b> |                 |             |                 |             |
| Beginning balance                | \$ 12,862       | \$ 14,510   | \$ 12,833       | \$ 14,549   |
| Provision for loan losses        | 937             |             | 1,260           |             |
| Charge-offs                      | (1,198)         | (911)       | (2,164)         | (1,804)     |
| Recoveries                       | 832             | 335         | 1,504           | 1,189       |
| Net charge-offs                  | (366)           | (576)       | (660)           | (615)       |
| Ending balance                   | \$ 13,433       | \$ 13,934   | \$ 13,433       | \$ 13,934   |

The total allowance for loan losses to loans held for investment ratio was 1.14% at June 30, 2008, compared with 1.05% at December 31, 2007, and 1.12% at June 30, 2007. Management considers the allowance adequate based upon its analysis of the portfolio as of June 30, 2008. 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.

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Throughout the second quarter and first half of 2008, the Company had net charge-offs of \$366 thousand and \$660 thousand, respectively, compared with \$576 thousand and \$615 thousand in the respective periods of 2007. Annualized net charge-offs for the second quarter and first half of 2008 were 0.12% and 0.11%, respectively. The Company made provisions for loan losses of \$937 thousand and \$1.26 million for the second quarter and first half of 2008, respectively. No provision was required in the respective periods of 2007.

**Noninterest Income**

Noninterest income consists of all revenues that are not included in interest and fee income related to earning assets. Noninterest income for the second quarter of 2008 was \$7.72 million compared with \$5.55 million in the same period of 2007, an increase of \$2.18 million, or 39.25%. Wealth management revenues increased \$93 thousand, or 9.25%, to \$1.10 million for the three months ended June 30, 2008, compared with the same period in 2007. Service charges on deposit accounts increased \$801 thousand, or 30.09%, to \$3.46 million for the three months ended June 30, 2008, compared with the same period in 2007. The strong increase in deposit service charges reflects the continuing success of new retail programs and initiatives implemented in the third quarter of 2007, which have positively impacted account service charges and new account openings. Other service charges, commissions, and fees increased \$227 thousand, or 27.12%, to \$1.06 million for the three months ended June 30, 2008, compared with the same period in 2007. Increases include higher levels of ATM service charges and electronic interchange income. Insurance commissions for the second quarter of 2008 were \$1.15 million. Other operating income was \$803 thousand for the three months ended June 30, 2008, a decrease of \$210 thousand, or 20.73%, compared with the same period in 2007. During the second quarter of 2008, securities gains of \$150 thousand were realized, compared with a gain of \$30 thousand in the comparable period in 2007.

Noninterest income for the first half of 2008 was \$16.87 million compared with \$10.76 million in the same period of 2007, an increase of \$6.10 million, or 56.71%. Wealth management revenues decreased \$26 thousand, or 1.29%, to \$2.00 million for the six months ended June 30, 2008, compared with the same period in 2007. Wealth management revenues were slightly elevated in the first quarter of 2007 as the Trust Division settled several large estates. Service charges on deposit accounts increased \$1.49 million, or 29.40%, to \$6.56 million for the six months ended June 30, 2008, compared with the same period in 2007. Other service charges, commissions, and fees increased \$478 thousand, or 28.00%, to \$2.19 million for the six months ended June 30, 2008, compared with the same period in 2007. Deposit service charges and other service charges and commissions reflect the year-to-date impact of the previously discussed retail program changes. Insurance commissions for the first half of 2008 were \$2.49 million. Other operating income was \$1.66 million for the three months ended June 30, 2008, a decrease of \$141 thousand, or 7.82%, compared with the same period in 2007. During the first half of 2008, securities gains of \$1.97 million were realized compared with a gain of \$159 thousand in the comparable period in 2007. During the first quarter of 2008, certain investment securities in the Company's portfolio significantly increased in value following the passage of a one-time call opportunity, and as the interest rate environment declined, the Company elected to monetize that value.

**Noninterest Expense**

Noninterest expense totaled \$14.76 million for the quarter ended June 30, 2008, an increase of \$2.68 million, or 22.23%, from the same period in 2007. Salaries and benefits for the first quarter of 2008 increased \$1.42 million, or 22.95%, compared to the same period in 2007. Salaries and benefits at GreenPoint accounted for \$567 thousand of the increase in the first quarter of 2008 over the prior first quarter. Increases in retirement plan accruals, incentive compensation accruals, and commissions expense made up the remainder of the increase. Other non-interest expense totaled \$4.79 million for the second quarter of 2008, an increase of \$787 thousand, or 19.65%, from \$4.01 million for the first quarter of 2007. The increase between comparable periods is due mostly to increases in consulting expense, new account promotions, and legal expenses. Occupancy and furniture and fixtures expenses increased between the comparable periods with the addition of GreenPoint and the new branches.

Noninterest expense totaled \$31.04 million for the six months ended June 30, 2008, an increase of \$6.81 million, or 28.10%, from the same period in 2007. Salaries and benefits for the first half of 2008 increased \$2.79 million, or 22.22%, compared to the same period in 2007. Salaries and benefits at GreenPoint accounted for \$1.21 million of the increase in the first half of 2008 over the prior year. Increases in retirement plan accruals, incentive compensation accruals, and commissions expense made up the remainder of the increase. Included in noninterest expense for the



first half of 2008 is a prepayment penalty of \$1.65 million incurred in connection with the early payment of a \$25.00 million FHLB advance. Other non-interest expense totaled \$9.41 million for the first half of 2008, an increase of \$1.64 million, or 21.16%, from \$7.77 million for the first half of 2007. The increase between comparable periods is due mostly to increases in legal and consulting expense and new account promotions. Occupancy and furniture and fixtures expenses increased between the comparable periods with the addition of GreenPoint and the new branches.

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**Table of Contents****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 2008, income taxes were \$2.42 million compared with \$3.05 million for the second quarter of 2007. For the quarters ended June 30, 2008 and 2007, the effective tax rates were 27.91% and 29.06%, respectively. For the six months ended June 30, 2008, income taxes were \$5.00 million compared with \$6.00 million for the same period in 2007. For the six months ended June 30, 2008 and 2007, the effective tax rates were 28.48% and 29.16%, respectively.

**FINANCIAL CONDITION**

Total assets at June 30, 2008, decreased \$96.15 million, or 4.47%, to \$2.05 billion from December 31, 2007. The decline reflects continued loan payoffs and managed attrition of high-rate deposit, single-service households.

**Securities**

Available-for-sale securities were \$598.44 million at June 30, 2008, compared with \$664.12 million at December 31, 2007, a decrease of \$65.68 million, or 9.89%. Held-to-maturity securities declined to \$10.51 million at June 30, 2008, compared with \$12.08 million at December 31, 2007.

The Company's available-for-sale securities portfolio is reported at fair value. The fair value of most securities is determined based on third party model prices. Available-for-sale and held-to-maturity securities are reviewed quarterly for 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. 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, changes in market credit risk premiums, and current market illiquidity. The Company's portfolio of trust-preferred securities are generally collateralized with bank-issued debt, rated A or higher, have not had a credit rating downgrade, and have not deferred an interest payment.

The Company has a portfolio of trust-preferred securities with a total market value of approximately \$123.57 million as of June 30, 2008. That portfolio is comprised of single-issue securities and pooled trust-preferred securities. The single-issue securities are trust-preferred issuances from some of the largest banks in the nation and had a total market value of approximately \$44.48 million as of June 30, 2008, compared with their adjusted cost basis of approximately \$55.44 million.

At June 30, 2008, the total market value of the pooled trust-preferred securities was approximately \$79.09 million, compared with an adjusted cost basis of approximately \$108.93 million. The collateral underlying these securities is comprised of 86% of bank trust-preferred securities and subordinated debt issuances. The remaining collateral is from REITs and insurance companies. All of the pooled trust-preferred securities are A-rated, have not been subject to a credit rating downgrade, and have not deferred an interest payment. Certain of these securities are, however, on negative watch by one or more rating firms. The securities carry variable rate structures that float at a prescribed margin over 3-month LIBOR. The Company has modeled the expected cash flows from the pooled trust-preferred securities and at present does not expect to have an adverse cash flow effect under any of the scenarios modeled due to the existence of other subordinate classes within the pools.

Although the Company has both the intent and ability to hold the securities to maturity, the Company is closely monitoring this portfolio due to the substantial market discounts. The market discounts are due to credit market disruption in bank subordinated debt instruments and the possibility of future negative credit events within the banking sector, which could affect collateral within certain of the pools and single-issue securities.



**Table of Contents****Loan Portfolio**

**Loans Held for Sale:** The \$1.52 million balance of loans held for sale at June 30, 2008, 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, 2008, was \$7.20 million on 44 loans.

**Loans Held for Investment:** Total loans held for investment were \$1.18 billion at June 30, 2008, representing declines of \$44.40 million and \$61.97 million from December 31 and June 30, 2007, respectively. The average loan to deposit ratio decreased to 88.10% for the second quarter of 2008, compared with 88.49% for the fourth quarter of 2007 and 88.82% for the second quarter of 2007. Average loans of \$1.18 billion for the second quarter of 2008 decreased \$72.87 million when compared with the second quarter of 2007 average of \$1.25 billion.

Over the course of the last three years, the Company has taken measures to tighten its commercial underwriting standards. The more stringent underwriting has led to improved credit quality, but, coupled with the loss of commercial loan officers, has resulted in decreases in the loan portfolio. The Company also continues to realize net payoffs in the area of consumer finance, as it competes with credit card lenders and captive automobile finance companies.

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, 2008, December 31, 2007, and June 30, 2007.

| <i>(Dollars in Thousands)</i>    | <b>June 30, 2008</b> |                | <b>December 31, 2007</b> |                | <b>June 30, 2007</b> |                |
|----------------------------------|----------------------|----------------|--------------------------|----------------|----------------------|----------------|
|                                  | <b>Amount</b>        | <b>Percent</b> | <b>Amount</b>            | <b>Percent</b> | <b>Amount</b>        | <b>Percent</b> |
| <b>Loans Held for Investment</b> |                      |                |                          |                |                      |                |
| Commercial and agricultural      | \$ 85,833            | 7.27%          | \$ 96,261                | 7.85%          | \$ 96,835            | 7.79%          |
| Commercial real estate           | 385,870              | 32.67%         | 386,112                  | 31.51%         | 394,418              | 31.73%         |
| Residential real estate          | 490,519              | 41.53%         | 498,345                  | 40.66%         | 498,156              | 40.07%         |
| Construction                     | 144,094              | 12.20%         | 163,310                  | 13.33%         | 166,010              | 13.35%         |
| Consumer                         | 67,572               | 5.72%          | 75,447                   | 6.16%          | 83,665               | 6.73%          |
| Other                            | 7,219                | 0.61%          | 6,027                    | 0.49%          | 3,992                | 0.33%          |
| <b>Total</b>                     | <b>\$ 1,181,107</b>  | <b>100.00%</b> | <b>\$ 1,225,502</b>      | <b>100.00%</b> | <b>\$ 1,243,076</b>  | <b>100.00%</b> |
| <b>Loans Held for Sale</b>       | <b>\$ 1,522</b>      |                | <b>\$ 811</b>            |                | <b>\$ 1,818</b>      |                |

**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 \$4.63 million at June 30, 2008, \$3.47 million at December 31, 2007, and \$3.50 million at June 30, 2007. The increase in non-performing assets stems largely from the addition of two loans in the Richmond market. Those loans have been appropriately reserved for based on management's analysis of potential impairment. The percentage of non-performing assets to total loans and OREO was 0.39% at June 30, 2008, 0.28% at December 31, 2007, and 0.28% at June 30, 2007.

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The following schedule details non-performing assets by category at the close of each of the quarters ended June 30, 2008 and 2007, and December 31, 2007.

| <i>(In Thousands)</i>   | <b>June 30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> | <b>June 30,<br/>2007</b> |
|---|--------------------------|----------------------------------|--------------------------|
| Non-accrual   | \$ 4,126                 | \$ 2,923                         | \$ 2,910                 |
| Ninety days past due and accruing                               |                          |                                  |                          |
| Other real estate owned   | 500                      | 545                              | 593                      |
| Total non-performing assets                                     | \$ 4,626                 | \$ 3,468                         | \$ 3,503                 |
| Restructured loans performing in accordance with modified terms | \$ 231                   | \$ 245                           | \$ 256                   |

Ongoing activity within the classification and categories of non-performing loans includes collections on delinquencies, foreclosures and movements into or out of the non-performing classification as a result of changing customer business conditions. OREO was \$500 thousand at June 30, 2008, and is carried at the lesser of estimated net realizable value or cost.

**Deposits and Other Borrowings**

Total deposits decreased by \$54.04 million, or 3.88%, during the first six months of 2008. Non interest-bearing demand deposits increased \$629 thousand to \$224.72 million at June 30, 2008, compared with \$224.09 million at December 31, 2007. Interest-bearing demand deposits increased \$19.05 million to \$172.62 million at June 30, 2008. Savings decreased \$15.54 million, or 4.74%, and time deposits decreased \$58.18 million, or 8.45%, during the first half of 2008. Throughout the last nine months, the Company has aggressively lowered money market and certificate of deposit rates, which is the main cause of the decreases in deposits.

Securities sold under repurchase agreements increased \$8.18 million, or 3.95%, in the first six months of 2008 to \$215.61 million. There were \$66.50 million in federal funds purchased outstanding at June 30, 2008. Overnight balances increased as the Company replaced high-cost term advances with low-cost, short-term funds.

**Stockholders Equity**

Total stockholders equity decreased \$20.49 million, or 9.44%, from \$217.10 million at December 31, 2007, to \$196.61 million at June 30, 2008, as the Company pursued its stock repurchase program and experienced increases in other comprehensive losses associated with the Company's investments portfolio. The change in equity was the result of net earnings of \$12.55 million, less dividends paid to stockholders of \$6.15 million, common stock repurchases of \$4.11 million, and other comprehensive loss of \$22.45 million.

The Company repurchased 128,100 shares of its common stock in the first half of 2008. The share repurchases were conducted as part of a share repurchase plan previously adopted by the Company.

**Risk-Based Capital**

Risk-based capital guidelines promulgated by federal banking agencies weight balance sheet assets and off-balance sheet commitments based on inherent risks associated with the respective asset types. At June 30, 2008, the Company's total capital to risk-weighted assets ratio was 12.96% compared with 12.34% at December 31, 2007. The Company's Tier 1 capital to risk-weighted assets ratio was 12.00% at June 30, 2008, compared with 11.45% at December 31, 2007. The Company's Tier 1 leverage ratio at June 30, 2008, was 8.53% compared with 8.09% at December 31, 2007. All of the Company's regulatory capital ratios exceed the current well-capitalized levels.

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

**Liquidity and Capital Resources**

At June 30, 2008, the Company maintained a significant level of liquidity in the form of cash and cash equivalent balances of \$55.42 million, unpledged securities available-for-sale of \$222.67 million, and FHLB credit availability of approximately \$22.76 million. Cash and cash equivalents as well as advances from the FHLB are immediately available for satisfaction of deposit withdrawals, customer credit needs and operations of the Company. Investment securities available-for-sale represent a secondary level of liquidity available for conversion to liquid funds in the event of extraordinary needs. The Company also maintains approved lines of credit with correspondent banks as backup liquidity sources.

The Company maintains a liquidity policy as a means to manage liquidity and the associated risk. The policy includes a Liquidity Contingency Plan (the Liquidity Plan ) that is designed as a tool for the Company to detect liquidity issues promptly in order to protect depositors, creditors and shareholders. The Liquidity Plan includes monitoring various internal and external indicators such as changes in core deposits and changes in market conditions. It provides for timely responses to a wide variety of funding scenarios ranging from changes in loan demand to a decline in the Company's quarterly earnings to a decline in the market price of the Company's stock. The Liquidity Plan calls for specific responses designed to meet a wide range of liquidity needs based upon assessments on a recurring basis by the Company and its Board of Directors.

**Interest Rate Risk and Asset/Liability Management**

The Company's profitability is dependent to a large extent upon its net interest income, which is the difference between its interest income on interest-earning assets, such as loans and securities, and its interest expense on interest-bearing liabilities, such as deposits and borrowings. The Company, like other financial institutions, is subject to interest rate risk to the degree that interest-earning assets reprice differently than interest-bearing liabilities. The Company manages its mix of assets and liabilities with the goals of limiting its exposure to interest rate risk, ensuring adequate liquidity, and coordinating its sources and uses of funds while maintaining an acceptable level of net interest income given the current interest rate environment.

The Company's primary component of operational revenue, net interest income, is subject to variation as a result of changes in interest rate environments in conjunction with unbalanced repricing opportunities on earning assets and interest-bearing liabilities. Interest rate risk has four primary components: repricing risk, basis risk, yield curve risk and option risk. Repricing risk occurs when earning assets and paying liabilities reprice at differing times as interest rates change. Basis risk occurs when the underlying rates on the assets and liabilities the institution holds change at different levels or in varying degrees. Yield curve risk is the risk of adverse consequences as a result of unequal changes in the spread between two or more rates for different maturities for the same instrument. Lastly, option risk is due to embedded options, often put or call options, given or sold to holders of financial instruments.

In order to mitigate the effect of changes in the general level of interest rates, the Company manages repricing opportunities and thus, its interest rate sensitivity. The Company seeks to control its interest rate risk exposure to insulate net interest income and net earnings from fluctuations in the general level of interest rates. To measure its exposure to interest rate risk, quarterly simulations of net interest income are performed using financial models that project net interest income through a range of possible interest rate environments including rising, declining, most likely and flat rate scenarios. The simulation model used by the Company captures all earning assets, interest-bearing liabilities and all off-balance sheet financial instruments and combines the various factors affecting rate sensitivity into an earnings outlook. The results of these simulations indicate the existence and severity of interest rate risk in each of those rate environments based upon the current balance sheet position, assumptions as to changes in the volume and mix of interest-earning assets and interest-paying liabilities and the Company's estimate of yields to be attained in those future rate environments and rates that will be paid on various deposit instruments and borrowings. These assumptions are inherently uncertain and, as a result, the model cannot precisely predict the impact of fluctuations in interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude, and frequency of interest rate changes, as well as changes in market conditions and the Company's strategies. However, the earnings simulation model is currently the best tool available to the Company for managing interest rate risk.

Specific strategies for management of interest rate risk have included shortening the amortized maturity of new fixed-rate loans, increasing the volume of adjustable-rate loans to reduce the average maturity of the Company's interest-earning assets, and monitoring the term and structure of liabilities to maintain a balanced mix of maturity and repricing structures to mitigate potential exposure. Although the Company is in a neutral position, significantly more assets reprice in the short term than do liabilities, creating potential for net interest income to be negatively impacted in a declining rate environment.

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The Company has established policy limits for tolerance of interest rate risk that allow for no more than a 10% reduction in projected net interest income for the next twelve months based on a comparison of net interest income simulations in various interest rate scenarios. In addition, the policy addresses exposure limits to changes in the economic value of equity according to predefined policy guidelines. The most recent simulation indicates that current exposure to interest rate risk is within the Company's defined policy limits.

The following table summarizes the projected impact on the next twelve months' net interest income and the economic value of equity as of June 30, 2008, and December 31, 2007, of immediate and sustained rate shocks in the interest rate environments of plus and minus 100 and 200 basis points from the base simulation, assuming no remedial measures are effected.

The economic value of equity is a measure which reflects the impact of changing rates on the underlying values of the Company's assets and liabilities in various rate scenarios. The scenarios illustrate the potential estimated impact of instantaneous rate shocks on the underlying value of equity. The economic value of the equity is based on the present value of all the future cash flows under the different rate scenarios.

**Rate Sensitivity Analysis**

*(Dollars in  
Thousands)*

| <b>Increase<br/>(Decrease) in<br/>Interest Rates<br/>(Basis Points)</b> | <b>June 30, 2008</b>                             |                     | <b>December 31, 2007</b>                              |                     |
|---|--|---------------------|---|---------------------|
|   | <b>Change in<br/>Net<br/>Interest<br/>Income</b> | <b>%<br/>Change</b> | <b>Change in<br/>Economic<br/>Value<br/>of Equity</b> | <b>%<br/>Change</b> |
| 200   | \$ (22)  |                     | \$ 38   | 0.2                 |
| 100   | 723  | 1.1                 | 488   | 2.1                 |
| (100)   | (933)  | (1.4)               | (608)   | (2.7)               |
| (200)   | (3,491)  | (5.1)               | (2,276)   | (10.0)              |
| 200   | \$(3,124)  | (4.2)               | \$(30,894)  | (10.7)              |
| 100   | (327)  | (0.4)               | (5,315)   | (1.8)               |
| (100)   | (449)  | (0.6)               | (11,128)  | (3.9)               |
| (200)   | (1,657)  | (2.2)               | (32,008)  | (11.1)              |

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**PART I. ITEM 4. Controls and Procedures**

**Disclosure Controls and Procedures**

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ( CEO ) along with the Company's Chief Financial Officer ( CFO ), of the effectiveness of the Company's disclosure controls and procedures pursuant to the Securities Exchange Act of 1934 ( Exchange Act ) Rule 13a-15(b). Based on that evaluation, the Company's CEO along with the Company's CFO concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

The Company's management, including the CEO and CFO, does not expect that the Company's disclosure controls and internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls.

**Changes in Internal Control Over Financial Reporting**

There have not been any changes in the Company's internal controls over financial reporting during the quarter ended June 30, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. Legal Proceedings**

The Company is currently a defendant in various legal actions and asserted claims in the normal course of business. Although the Company and legal counsel are unable to assess the ultimate outcome of each of these matters with certainty, they are of the belief that the resolution of these actions should not have a material adverse affect on the financial position, results of operations, or cash flows of the Company.

**ITEM 1A. Risk Factors**

There were no material changes to the risk factors as presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) Not Applicable

(b) Not Applicable

(c) Issuer Purchases of Equity Securities

The following table sets forth open market purchases by the Company of its equity securities during the three months ended June 30, 2008.

|                  | <b>Total # of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid<br/>per<br/>Share</b> | <b>Total Number<br/>of<br/>Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plan</b> | <b>Maximum<br/>Number of<br/>Shares That<br/>May<br/>Yet be<br/>Purchased<br/>Under the<br/>Plan</b> |
|------------------|--|---|--|--|
| April 1-30, 2008 | 4,100                                      | \$ 34.84  | 4,100  | 59,456   |
| May 1-31, 2008   | 24,700                                     | 32.64   | 24,700   | 36,706   |
| June 1-30, 2008  | 32,000                                     | 31.05   | 32,000   | 5,060  |
| Total            | 60,800                                     | \$ 31.95  | 60,800   |  |

The Company's stock repurchase plan, as amended, allows the purchase and retention of up to 550,000 shares. The plan has no expiration date and remains open. The Company held 544,940 shares in treasury at June 30, 2008.

**ITEM 3. Defaults Upon Senior Securities**

Not Applicable

**ITEM 4. Submission of Matters to a Vote of Security Holders**

Not Applicable

**ITEM 5. Other Information**

Not Applicable

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**ITEM 6. Exhibits**

(a) Exhibits

| <b>Exhibit No.</b> | <b>Exhibit</b>  |
|--------------------|---|
| 3.1                | Articles of Incorporation of First Community Bancshares, Inc., as amended. (1)  |
| 3.2                | Bylaws of First Community Bancshares, Inc., as amended. (15)  |
| 4.1                | Specimen stock certificate of First Community Bancshares, Inc. (3)  |
| 4.2                | Indenture Agreement dated September 25, 2003. (10)  |
| 4.3                | Amended and Restated Declaration of Trust of FCBI Capital Trust dated September 25, 2003. (10)  |
| 4.4                | Preferred Securities Guarantee Agreement dated September 25, 2003. (10)   |
| 10.1               | First Community Bancshares, Inc. 1999 Stock Option Contracts (2) and Plan. (4)  |
| 10.1.1             | Amendment to First Community Bancshares, Inc. 1999 Stock Option Plan. (10)  |
| 10.2               | First Community Bancshares, Inc. 2001 Non-Qualified Directors Stock Option Plan. (5)  |
| 10.3               | Employment Agreement dated January 1, 2000 and amended October 17, 2000, between First Community Bancshares, Inc. and John M. Mendez. (2) (6) |
| 10.4               | First Community Bancshares, Inc. 2000 Executive Retention Plan, as amended. (2)   |
| 10.5               | First Community Bancshares, Inc. Split Dollar Plan and Agreement. (2)   |
| 10.6               | First Community Bancshares, Inc. 2001 Directors Supplemental Retirement Plan. (2)   |
| 10.6.1             | First Community Bancshares, Inc. 2001 Directors Supplemental Retirement Plan. Second Amendment (B.W. Harvey, Sr. October 19, 2004). (12)      |
| 10.7               | First Community Bancshares, Inc. Wrap Plan. (7)   |
| 10.8               | Reserved.   |
| 10.9               | Form of Indemnification Agreement between First Community Bancshares, Inc. and its Directors and Certain Executive Officers. (8)              |
| 10.10              | Form of Indemnification Agreement between First Community Bank, N. A., its Directors and Certain Executive Officers. (8)                      |
| 10.11              | Reserved.   |
| 10.12              | First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan (9) and Award Agreement. (11)   |

- 10.13 Reserved.
- 10.14 First Community Bancshares, Inc. Directors Deferred Compensation Plan. (7)
- 10.15 First Community Bancshares, Inc. Deferred Compensation and Supplemental Bonus Plan For Key Employees. (13)
- 10.16 Employment Agreement dated November 30, 2006, between First Community Bank, N. A. and Ronald L. Campbell. (16)
- 10.17 Employment Agreement dated September 28, 2007, between GreenPoint Insurance Group, Inc. and Shawn C. Cummings. (17)
- 31.1 Rule 13a-14(a)/a5d-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a)/a5d-14(a) Certification of Chief Financial Officer
- 32 Certification of Chief Executive Officer and Chief Financial Officer Section 1350.
- (1) Incorporated by reference from Exhibit 3.1 of the Quarterly Report on Form 10-Q for the period ended March 31, 2007, filed on May 10, 2007.
- (2) Incorporated by reference from the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
- (3) Incorporated by reference from Exhibit 4.1 of the Annual Report on Form 10-K for the period ended December 31, 2002, filed on March 25, 2003,

as amended on  
March 31, 2003.

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- (4) Incorporated by reference from Exhibit 10.1 of the Annual Report on Form 10-K for the period ended December 31, 1999, filed on March 30, 2000, as amended April 13, 2000.
  
- (5) The option agreements entered into pursuant to the 1999 Stock Option Plan and the 2001 Non-Qualified Directors Stock Option Plan are incorporated by reference from the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
  
- (6) First Community Bancshares, Inc. has entered into substantially identical agreements with Robert L. Buzzo and E. Stephen Lilly, with the only differences being with respect to title, salary and the use of a vehicle.

- (7) Incorporated by reference from Item 1.01 of the Current Report on Form 8-K dated August 22, 2006, and filed August 23, 2006.
  
- (8) Form of indemnification agreement entered into by the Company and by First Community Bank, N. A. with their respective directors and certain officers of each including, for the Registrant and Bank: John M. Mendez, Robert L. Schumacher, Robert L. Buzzo, E. Stephen Lilly, David D. Brown, and Gary R. Mills. Incorporated by reference from Exhibits 10.10 and 10.11 of Annual Report on Form 10-K for the period ended December 31, 2003, filed on March 15, 2004, and amended on May 19, 2004.

- (9) Incorporated by reference from the 2004 First Community Bancshares, Inc. Definitive Proxy filed on March 19, 2004.
- (10) Incorporated by reference from the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.
- (11) Incorporated by reference from Exhibit 10.13 of the Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed on August 6, 2004.
- (12) Incorporated by reference from Exhibit 10.6.1 of the Annual Report on Form 10-K for the period ended December 31, 2004, and filed on March 16, 2005. Amendments in substantially similar form were executed for Directors Clark, Kantor, Hamner, Modena, Perkinson,



Stafford, and  
Stafford, II.

- (13) Incorporated by reference from Item 1.01 of the Current Report on Form 8-K dated October 24, 2006, and filed October 25, 2006.
- (14) Reserved.
- (15) Incorporated by reference from Exhibit 3.2 of the Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed on November 8, 2006.
- (16) Incorporated by reference from Exhibit 2.1 of the Form S-3 registration statement filed May 2, 2007.
- (17) Incorporated by reference from Exhibit 10.17 of the Annual Report of Form 10-K for the period ended December 31, 2007, filed March 13, 2008.

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SIGNATURES

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

First Community Bancshares, Inc.

DATE: August 11, 2008

/s/ John M. Mendez

John M. Mendez

President & Chief Executive Officer

(Principal Executive Officer)

DATE: August 11, 2008

/s/ David D. Brown

David D. Brown

Chief Financial Officer

(Principal Accounting Officer)

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**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Exhibit</b>   |
|--------------------|--|
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer                            |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer                            |
| 32                 | Certification of Chief Executive and Chief Financial Officer pursuant to 18 USC Section 1350 |

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