

FIRST COMMUNITY BANCSHARES INC /NV/

Form 10-Q

November 10, 2008

**Table of Contents**

**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 September 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   
(Do not check if a smaller reporting  
company)

Smaller reporting  
company

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

Yes  No

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

Class Common Stock, \$1.00 Par Value; 10,968,097 shares outstanding as of November 3, 2008

FIRST COMMUNITY BANCSHARES, INC.  
FORM 10-Q  
For the quarter ended September 30, 2008  
INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets as of September 30, 2008 (Unaudited) and December 31, 2007 3

Consolidated Statements of Income for the Three- and Nine-Month Periods Ended September 30, 2008 and 2007 (Unaudited) 4

Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2008 and 2007 (Unaudited) 5

Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2008 and 2007 (Unaudited) 6

Notes to Consolidated Financial Statements 7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 17

Item 3. Quantitative and Qualitative Disclosures about Market Risk 30

Item 4. Controls and Procedures 32

PART II. OTHER INFORMATION

Item 1. Legal Proceedings 33

Item 1A. Risk Factors 33

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 33

Item 3. Defaults Upon Senior Securities 33

Item 4. Submission of Matters to a Vote of Security Holders 33

Item 5. Other Information 34

Item 6. Exhibits 34

SIGNATURES 36

EXHIBIT INDEX 37

EX-31.1

EX-31.2

EX-32

**Table of Contents****PART I. ITEM 1. Financial Statements****FIRST COMMUNITY BANCSHARES, INC.  
CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2008 (Unaudited)</b>	<b>December 31, 2007</b>
<i>(Dollars in Thousands, Except Per Share Data)</i>		
<b>Assets</b>		
Cash and due from banks	\$ 53,238	\$ 50,051
Interest-bearing balances with banks	664	2,695
Total cash and cash equivalents	53,902	52,746
Securities available-for-sale (amortized cost of \$607,249 at September 30, 2008; \$674,937 at December 31, 2007)	513,001	664,120
Securities held-to-maturity (fair value of \$9,187 at September 30, 2008; \$12,298 at December 31, 2007)	9,043	12,075
Loans held for sale	140	811
Loans held for investment, net of unearned income	1,168,286	1,225,502
Less allowance for loan losses	14,510	12,833
Net loans held for investment	1,153,776	1,212,669
Premises and equipment	50,504	48,383
Other real estate owned	896	545
Interest receivable	9,156	12,465
Goodwill and other intangible assets	72,222	70,056
Other assets	104,817	75,968
Total Assets	\$ 1,967,457	\$ 2,149,838
<b>Liabilities</b>		
Deposits:		
Noninterest-bearing	\$ 214,582	\$ 224,087
Interest-bearing	1,134,962	1,169,356
Total Deposits	1,349,544	1,393,443
Interest, taxes and other liabilities	20,494	21,454
Federal funds purchased	29,500	18,500
Securities sold under agreements to repurchase	180,388	207,427
FHLB borrowings and other indebtedness	216,720	291,916
Total Liabilities	1,796,646	1,932,740
<b>Stockholders Equity</b>		
Preferred stock, par value undesignated; 1,000,000 shares authorized; none issued		

Edgar Filing: FIRST COMMUNITY BANCSHARES INC /NV/ - Form 10-Q

Common stock, \$1 par value; 25,000,000 shares authorized; 11,499,018 shares issued at September 30, 2008, and December 31, 2007, including 531,421 and 429,372 shares in treasury, respectively	11,499	11,499
Additional paid-in capital	108,862	108,825
Retained earnings	124,731	117,670
Treasury stock, at cost	(16,882)	(13,613)
Accumulated other comprehensive loss	(57,399)	(7,283)
 Total Stockholders' Equity	 170,811	 217,098
 Total Liabilities and Stockholders' Equity	 \$ 1,967,457	 \$ 2,149,838

*See Notes to Consolidated Financial Statements.*

-3-

---

**Table of Contents**

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

<i>(Dollars in Thousands, Except Per Share Data)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Interest Income</b>				
Interest and fees on loans held for investment	\$ 19,266	\$ 23,478	\$ 60,394	\$ 70,401
Interest on securities-taxable	5,567	6,772	17,101	17,783
Interest on securities-nontaxable	1,708	2,078	5,775	6,140
Interest on deposits in banks	9	404	260	1,073
<b>Total interest income</b>	<b>26,550</b>	<b>32,732</b>	<b>83,530</b>	<b>95,397</b>
<b>Interest Expense</b>				
Interest on deposits	6,684	10,083	22,543	29,131
Interest on borrowings	3,543	5,506	11,679	15,094
<b>Total interest expense</b>	<b>10,227</b>	<b>15,589</b>	<b>34,222</b>	<b>44,225</b>
Net interest income	16,323	17,143	49,308	51,172
Provision for loan losses	3,461		4,721	
Net interest income after provision for loan losses	12,862	17,143	44,587	51,172
<b>Noninterest Income</b>				
Wealth management income	957	908	2,954	2,931
Service charges on deposit accounts	3,808	3,006	10,370	8,077
Other service charges, commissions and fees	1,040	902	3,225	2,609
Insurance commissions	1,240		3,730	
Gain on sale of securities	163	50	2,133	209
Other operating income	675	1,154	2,336	2,956
<b>Total noninterest income</b>	<b>7,883</b>	<b>6,020</b>	<b>24,748</b>	<b>16,782</b>
<b>Noninterest Expense</b>				
Salaries and employee benefits	7,371	6,544	22,741	19,120
Occupancy expense of bank premises	1,297	933	3,717	3,010
Furniture and equipment expense	924	844	2,798	2,447
Intangible amortization	166	105	484	313
Prepayment penalty on FHLB advance			1,647	
Other operating expense	4,683	4,410	14,096	12,179
<b>Total noninterest expense</b>	<b>14,441</b>	<b>12,836</b>	<b>45,483</b>	<b>37,069</b>
Income before income taxes	6,304	10,327	23,852	30,885
Income tax expense	1,753	3,011	6,751	9,006
Net income	\$ 4,551	\$ 7,316	\$ 17,101	\$ 21,879

Edgar Filing: FIRST COMMUNITY BANCSHARES INC /NV/ - Form 10-Q

Basic earnings per common share	\$	0.42	\$	0.65	\$	1.56	\$	1.95
Diluted earnings per common share	\$	0.41	\$	0.65	\$	1.54	\$	1.94
Dividends declared per common share	\$	0.28	\$	0.27	\$	0.84	\$	0.81
Weighted average basic shares outstanding		10,956,867		11,179,322		10,992,901		11,232,895
Weighted average diluted shares outstanding		11,034,059		11,230,220		11,071,925		11,299,727
<i>See Notes to Consolidated Financial Statements.</i>								

-4-

---

**Table of Contents**

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

<i>(In Thousands)</i>	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Operating activities:		
Net Income	\$ 17,101	\$ 21,879
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	4,721	
Depreciation and amortization of premises and equipment	2,785	2,362
Intangible amortization	484	313
Net investment amortization and accretion	(292)	435
Net gain on the sale of assets	(2,070)	(186)
Mortgage loans originated for sale	(28,299)	(34,794)
Proceeds from sales of mortgage loans	29,137	33,472
Gain on sales of loans	(167)	(191)
Deferred income tax (benefit) expense	(330)	552
Decrease (increase) in interest receivable	3,309	(1,148)
Other operating activities, net	2,522	(967)
 Net cash provided by operating activities	 28,901	 21,727
Investing activities:		
Proceeds from sales of securities available-for-sale	97,232	1,288
Proceeds from maturities and calls of securities available-for-sale	80,997	22,258
Proceeds from maturities and calls of securities held-to-maturity	3,042	7,437
Purchase of securities available-for-sale	(108,124)	(196,479)
Net decrease in loans held for investment	54,828	44,322
Purchase of FHLB stock		(4,077)
Net cash used in insurance agency acquisitions	(1,080)	(5,135)
Proceeds from sales of equipment	23	
Purchase of premises and equipment	(4,922)	(11,981)
 Net cash provided by (used in) investing activities	 121,996	 (142,367)
Financing activities:		
Net increase in demand and savings deposits	8,088	13,283
Net decrease in time deposits	(51,987)	(5,180)
Net increase in federal funds purchased	11,000	7,900
Net (decrease) increase in securities sold under agreement to repurchase	(27,039)	25,599
Net (decrease) increase in FHLB and other borrowings	(75,196)	93,698
Prepayment penalty	(1,647)	
Proceeds from the exercise of stock options	440	715
Excess tax benefit from stock-based compensation	49	290
Acquisition of treasury stock	(4,222)	(5,035)
Dividends paid	(9,227)	(9,085)
 Net cash (used in) provided by financing activities	 (149,741)	 122,185



Increase in cash and cash equivalents	1,156	1,545
Cash and cash equivalents at beginning of period	52,746	57,759
Cash and cash equivalents at end of period	\$ 53,902	\$ 59,304
Supplemental information Noncash items		
Transfer of loans to other real estate	\$ 1,413	\$ 973
<i>See Notes to Consolidated Financial Statements.</i>		

-5-

---

**Table of Contents**

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

	<b>Common</b>	<b>Additional</b>	<b>Retained</b>	<b>Treasury</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Total</b>
<i>(Dollars in Thousands)</i>	<b>Stock</b>	<b>Capital</b>	<b>Earnings</b>	<b>Stock</b>	<b>(Loss)</b>	<b>Total</b>
Balance January 1, 2007	\$ 11,499	\$ 108,806	\$ 100,117	\$ (7,924)	\$ 232	\$ 212,730
Comprehensive income:						
Net income			21,879			21,879
Other comprehensive loss, net of tax:						
Unrealized loss on securities available for sale					(5,834)	(5,834)
Less reclassification adjustment for gains realized in net income					(16)	(16)
Unrealized gain on cash flow hedge					(372)	(372)
Comprehensive income			21,879		(6,222)	15,657
Common dividends declared			(9,085)			(9,085)
Acquisition of 163,500 treasury shares				(5,035)		(5,035)
Acquisition of GreenPoint Insurance 49,088 shares issued		133		1,524		1,657
Equity-based compensation expense		121		87		208
Tax benefit from exercise of stock options		337				337
Option exercises 41,470 shares		(603)		1,297		694
Balance September 30, 2007	\$ 11,499	\$ 108,794	\$ 112,911	\$ (10,051)	\$ (5,990)	\$ 217,163
Balance January 1, 2008	\$ 11,499	\$ 108,825	\$ 117,670	\$ (13,613)	\$ (7,283)	\$ 217,098
Comprehensive income:						
Net income			17,101			17,101
Other comprehensive loss, net of tax:						
Unrealized loss on securities available-for-sale					(49,081)	(49,081)
Less reclassification adjustment for gains realized in net income					(977)	(977)
Unrealized loss on cash flow hedge					(58)	(58)
Comprehensive loss			17,101		(50,116)	(33,015)
Cumulative effect of change in accounting principle			(813)			(813)

Edgar Filing: FIRST COMMUNITY BANCSHARES INC /NV/ - Form 10-Q

Common dividends declared			(9,227)			(9,227)
Acquisition of 132,100 treasury shares				(4,222)		(4,222)
Acquisition of GreenPoint Insurance Group 7,728 shares issued		22		245		267
Equity-based compensation expense		161				161
Tax benefit from exercise of stock options		122				122
Option exercises 22,323 shares		(268)		708		440
Balance September 30, 2008	\$ 11,499	\$ 108,862	\$ 124,731	\$ (16,882)	\$ (57,399)	\$ 170,811

*See Notes to Consolidated Financial Statements.*

**Table of Contents**

**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, 2004 through 2007 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 disclosures.

In December 2007, the FASB revised Statement No. 141, Business Combinations ( SFAS 141R ). 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.

**Table of Contents**

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, and Branching Activity**

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 of a share 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 has received the required regulatory approvals or waivers and been approved 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. In July 2008, GreenPoint acquired REL Insurance Agency for \$1.08 million in an all cash transaction. Under the terms of the agreement, the former principal of REL is entitled to additional consideration aggregating up to \$720 thousand, if certain operating targets are met. The acquisition and activity of GreenPoint has added a total \$9.86 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

**Table of Contents**

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.

**Note 3. Investment Securities**

As of September 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>September 30, 2008</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
U.S. Government agency securities	\$ 68,424	\$ 106	\$ (302)	\$ 68,228
States and political subdivisions	163,942	563	(7,976)	156,529
Trust-preferred securities	164,203		(76,681)	87,522
Mortgage-backed securities	202,214	397	(10,042)	192,569
Equities	8,466	402	(715)	8,153
<b>Total</b>	<b>\$ 607,249</b>	<b>\$ 1,468</b>	<b>\$ (95,716)</b>	<b>\$ 513,001</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>

As of September 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>September 30, 2008</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
States and political subdivisions	\$ 8,668	\$ 146	\$ (2)	\$ 8,812
Other securities	375			375
<b>Total</b>	<b>\$ 9,043</b>	<b>\$ 146</b>	<b>\$ (2)</b>	<b>\$ 9,187</b>

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



Total	\$ 12,075	\$	223	\$	\$ 12,298
-------	-----------	----	-----	----	-----------

**Table of Contents**

The following table reflects those investments in an unrealized loss position at September 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.

Description of Securities (In Thousands)	Less than 12 Months		September 30, 2008 12 Months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U. S. Government agency securities	\$ 58,122	\$ (302)	\$	\$	\$ 58,122	\$ (302)
States and political subdivisions	106,525	(5,217)	15,193	(2,761)	121,718	(7,978)
Trust-preferred securities	24,655	(33,745)	62,867	(42,936)	87,522	(76,681)
Mortgage-backed securities	141,804	(1,532)	19,205	(8,510)	161,009	(10,042)
Equity securities	2,806	(560)	2,268	(155)	5,074	(715)
<b>Total</b>	<b>\$ 333,912</b>	<b>\$ (41,356)</b>	<b>\$ 99,533</b>	<b>\$ (54,362)</b>	<b>\$ 433,445</b>	<b>\$ (95,718)</b>

Description of Securities	Less than 12 Months		December 31, 2007 12 Months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
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)
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)
<b>Total</b>	<b>\$ 179,727</b>	<b>\$ (13,784)</b>	<b>\$ 99,433</b>	<b>\$ (3,776)</b>	<b>\$ 279,160</b>	<b>\$ (17,560)</b>

At September 30, 2008, there were 375 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.

Included in available-for-sale securities is a portfolio of trust-preferred securities with a total market value of approximately \$87.52 million as of September 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, composite A-rated or higher, and had a total market value of approximately \$40.95 million as of September 30, 2008, compared with their adjusted cost basis of approximately \$55.45 million.

At September 30, 2008, the total market value of the pooled trust-preferred securities was approximately \$46.57 million, compared with an adjusted cost basis of approximately \$108.76 million. The collateral underlying these securities is comprised of 86% of bank trust-preferred securities and subordinated debt issuances of over 500 banks nationwide. The remaining collateral is from insurance companies and real estate investment trusts. During the third quarter, two of the securities experienced a credit rating downgrade from one rating agency, and certain of these securities are on negative credit watch by one or more rating firms. All of the pooled trust-preferred securities remain

composite A-rated and have not deferred an interest payment. 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 reflect the 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. Monitoring for other-than-temporary impairment ( OTI ) is dependent on the aforementioned assumptions regarding future credit events and the general strength of the banking industry as it deals with credit losses in the current recessionary real estate market. Acceleration of bank losses and

**Table of Contents**

the possibility of unforeseen bank failures could result in changes in the Company's outlook for these securities and possible future OTI. Accordingly, there can be no assurance that continued deterioration of credit portfolios within certain of those banks will not lead to unanticipated deferrals of interest payments and defaults. At present, cash flow modeling indicates varying ability to absorb additional deferrals and defaults before incurring breaks in interest or principal for the various pools.

**Note 4. Loans**

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

<i>(Dollars in Thousands)</i>	<b>September 30, 2008</b>		<b>December 31, 2007</b>	
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
Loans held for investment:				
Commercial and agricultural	\$ 83,271	7.13%	\$ 96,261	7.85%
Commercial real estate	386,287	33.06%	386,112	31.51%
Residential real estate	498,721	42.69%	498,345	40.66%
Construction	127,076	10.88%	163,310	13.33%
Consumer	66,333	5.68%	75,447	6.16%
Other	6,598	0.56%	6,027	0.49%
<b>Total</b>	<b>\$ 1,168,286</b>	<b>100.00%</b>	<b>\$ 1,225,502</b>	<b>100.00%</b>
Loans held for sale	\$ 140		\$ 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.

Financial instruments whose contract amounts represent credit risk are commitments to extend credit (including availability of lines of credit) of \$188.81 million and standby letters of credit and financial guarantees written of \$2.75 million at September 30, 2008. Additionally, the Company had gross notional amount of outstanding commitments to lend related to secondary market mortgage loans of \$4.36 million at September 30, 2008.

**Note 5. Allowance for Loan Losses**

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

-11-

---

**Table of Contents**

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 nine-month periods ended September 30, 2008 and 2007.

<i>(In Thousands)</i>	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Beginning balance	\$ 13,433	\$ 13,934	\$ 12,833	\$ 14,549
Provision for loan losses	3,461		4,721	
Charge-offs	(2,601)	(1,009)	(4,765)	(2,813)
Recoveries	217	265	1,721	1,454
Ending balance	\$ 14,510	\$ 13,190	\$ 14,510	\$ 13,190

**Note 6. Deposits**

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

<i>(In Thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Interest-bearing demand deposits	\$ 186,403	\$ 153,570
Savings and money market deposits	312,451	327,691
Certificates of deposit	636,108	688,095
Total	\$ 1,134,962	\$ 1,169,356

**Note 7. Borrowings**

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

<i>(In Thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
FHLB borrowings	\$ 200,835	\$ 275,888
Subordinated debt	15,464	15,464
Other long-term debt	421	564

Total	\$	216,720	\$	291,916
-------	----	---------	----	---------

FHLB borrowings include \$200.00 million in convertible and callable advances and \$835 thousand of noncallable term advances from the FHLB at September 30, 2008. The weighted average interest rate of advances was 3.24% and 4.38% at September 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

**Table of Contents**

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 was 3.74% at September 30, 2008. The fair value of the interest rate swap was a liability of \$1.42 million at September 30, 2008.

At September 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	200,835
Total	\$ 200,835

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

Also included in 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>	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net income	\$ 4,551	\$ 7,316	\$ 17,101	\$ 21,879
Other comprehensive income				
Unrealized loss on securities available-for-sale	(31,744)	(2,055)	(81,802)	(9,723)
Reclassification adjustment for (gains) losses realized in net income	(278)	52	(1,628)	(27)
Unrealized gain (loss) on derivative securities	(75)	(1,095)	(97)	(620)
Income tax effect	12,839	1,239	33,411	4,148
Total other comprehensive loss	(19,258)	(1,859)	(50,116)	(6,222)



Comprehensive (loss) income	\$ (14,707)	\$ 5,457	\$ (33,015)	\$ 15,657
-----------------------------	-------------	----------	-------------	-----------

-13-

---

**Table of Contents****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 deposit services. This segment provides customers with such products as commercial loans, real estate loans, business financing and consumer loans. This segment also 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.

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 nine-month periods ended September 30, 2008.

<i>(In Thousands)</i>	<b>For the Three Months Ended September 30, 2008</b>			
	<b>Community Banking</b>	<b>Insurance Services</b>	<b>Parent/ Elimination</b>	<b>Total</b>
Net interest income	\$ 16,559	\$ (19)	\$ (217)	\$ 16,323
Provision for loan losses	3,461			3,461
Noninterest income	3,923	1,267	2,693	7,883
Noninterest expense	13,635	1,110	(304)	14,441
Income before income taxes	3,386	138	2,780	6,304
Provision for income taxes	962	41	750	1,753
Net income	\$ 2,424	\$ 97	\$ 2,030	\$ 4,551

<i>(In Thousands)</i>	<b>For the Nine Months Ended September 30, 2008</b>			
	<b>Community Banking</b>	<b>Insurance Services</b>	<b>Parent/ Elimination</b>	<b>Total</b>
Net interest income	\$ 50,034	\$ (30)	\$ (696)	\$ 49,308
Provision for loan losses	4,721			4,721
Noninterest income	18,561	3,757	2,430	24,748
Noninterest expense	43,473	3,147	(1,137)	45,483
Income before income taxes	20,401	580	2,871	23,852
Provision for income taxes	5,763	171	817	6,751
Net income	\$ 14,638	\$ 409	\$ 2,054	\$ 17,101

End of period assets	\$ 1,938,358	\$ 10,889	\$ 18,210	\$ 1,967,457
----------------------	--------------	-----------	-----------	--------------

**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 FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157, the Company will delay application of FASB 157 for non- financial assets and non-financial liabilities until January 1, 2009. In October of 2008, the FASB issued Staff Position No. 157-3 ("FSP 157-3") to clarify the application of SFAS 157 in a market that is not active and to provide key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements were not issued. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

-14-

---

**Table of Contents**

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 value 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 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.

-15-

---

**Table of Contents**

*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.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 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	\$6,348	\$506,653	\$	\$513,001
Other assets	2,843			2,843
Derivative assets		377		377
Other liabilities	2,843			2,843
Derivative liabilities		1,786		1,786

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 \$5.98 million at September 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.

**Note 12: Subsequent Event**

On October 27, 2008, the Company received approval from the U.S. Treasury Department (the Treasury) to participate in the Capital Purchase Program developed by the Treasury Department under the Troubled Asset Relief Program. The terms of the program allow the Company to sell \$42.50 million of cumulative, perpetual, non-voting, senior preferred stock, and warrants to purchase common stock, to the Treasury. From the date of the approval, the Company has 30 days to execute the requisite documents.

**Table of Contents**

**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 \$1.97 billion at September 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 more than 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

-17-

---



**Table of Contents**

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

The Company's accounting policies are fundamental to understanding Management's Discussion and Analysis of Financial Condition and Results of Operation. The disclosures presented in the Notes to the Consolidated Financial Statements and in Management's Discussion and Analysis provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses, accounting for acquisitions and intangible assets, and accounting for income taxes as the accounting areas that require the most subjective or complex judgments. The identified critical accounting policies are described in detail in the Company's 2007 Annual Report on Form 10-K. Except for the critical accounting policy set forth below, there have been no material changes in the Company's critical accounting policies since December 31, 2007.

*Accounting for investment securities*

Management performs an extensive review of the investment securities portfolio quarterly to determine the cause of declines in the fair value of each security within each segment of the portfolio. The Company uses inputs provided by an independent third party to determine the fair values of its investment securities portfolio. Inputs provided by the third party are reviewed and corroborated by management. Evaluations of the causes of the unrealized losses are performed to determine whether the impairment is temporary or other-than-temporary in nature. Considerations such as the Company's intent and ability to hold the securities, recoverability of the invested amounts over the Company's intended holding period, severity in pricing decline and receipt of amounts contractually due, for example, are applied in determining whether a security is other-than-temporarily impaired. If a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. The impairment evaluations noted above are consistent with the accounting guidance in EITF 99-20 Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets, SFAS 115 Accounting for Certain Investments in Debt and Equity Securities, FASB Staff Position No. 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, and SEC Staff Accounting Bulletin No. 59, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities, to determine if a security is other than temporarily impaired. Securities deemed to be other than temporarily impaired are written-down to their current fair values with a charge to earnings. The review process uses a combination of the severity of pricing declines and the present value of the expected cash flows and compares those results to the current carrying value. Significant inputs provided by the independent third party such as default and loss severity are reviewed internally for reasonableness and from a market participant's perspective.

As of September 30, 2008, the Company has not determined any of its investment securities to be other than temporarily impaired.

**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 \$1.97 billion at September 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. Net interest income is supplemented by fees for services, commissions on sales, and various deposit service charges. 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 \$897 million. These assets are not assets of the Company, but are managed under various fee-based arrangements as fiduciary or agent.

-18-

---

**Table of Contents****Recent Market Developments**

The global and U.S. economies are experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system during the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities, have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

In response to the financial crises affecting the banking system and financial markets, Congress passed, and President Bush signed, the Emergency Economic Stabilization Act of 2008 (the EESA ) on October 3, 2008. Pursuant to the EESA, the U.S. Department of Treasury ( Treasury ) was granted the authority to, among others, purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, Treasury announced the Troubled Asset Relief Program Capital Purchase Program (the Capital Purchase Program ), under which it will purchase equity stakes in a wide variety of banks and thrifts. Pursuant to the Capital Purchase Program, Treasury will make \$250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions will be required to adopt Treasury s standards for executive compensation and corporate governance for the period during which Treasury holds equity issued under the Capital Purchase Program. On October 27, 2008, the Company was notified by the Treasury that it was preliminarily approved to participate in the Capital Purchase Program. The Company s participation in the Capital Purchase Program, as well as the amount Treasury may invest, is subject to Treasury s approval, the execution of definitive agreements, and standard closing conditions.

Additionally, on October 14, 2008, Treasury triggered the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction deposit accounts under a Temporary Liquidity Guarantee Program ( TLGP ). Coverage under the TLGP is available for 30 days without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum surcharge for non-interest bearing transaction deposits in excess of \$250,000 per account. The Company is currently evaluating its participation in the TLGP.

It is presently unclear what impact the EESA, the CPP, the TLGP, other previously announced liquidity and funding initiatives of the Federal Reserve and other agencies and any additional programs that may be initiated in the future will have on the financial markets and the other difficulties described above, or on the U.S. banking and financial industries and the broader U.S. and global economies. Further adverse effects could have an adverse impact on the Company and its business.

**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 transaction has received the required regulatory approvals or waivers and been approved by the stockholders of Coddle Creek. The merger is expected to be completed in the fourth quarter of 2008.

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

**Table of Contents**

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 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. In July 2008, GreenPoint acquired REL Insurance Agency for \$1.08 million in an all cash transaction. Under the terms of the agreement, the former principal of REL is entitled to additional consideration aggregating up to \$720 thousand, if certain operating targets are met. The acquisition and activity of GreenPoint has added a total \$9.86 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 September 30, 2008, was \$4.55 million, or \$0.42 per basic share and \$0.41 per diluted share, compared with \$7.32 million, or \$0.65 per basic and diluted share, for the three months ended September 30, 2007, a decrease of \$2.77 million, or 37.79%. Return on average assets was 0.90% for the three months ended September 30, 2008, compared with 1.34% for the same period in 2007. Return on average equity for the three months ended September 30, 2008, was 9.39% compared with 13.31% for the three months ended September 30, 2007.

Net income for the nine months ended September 30, 2008, was \$17.10 million, or \$1.56 per basic share and \$1.54 per diluted share, compared with \$21.88 million, or \$1.95 per basic share and \$1.94 per diluted share, for the nine months ended September 30, 2007, a decrease of \$4.78 million, or 21.84%. Return on average assets was 1.12% for the nine months ended September 30, 2008, compared with 1.38% for the same period in 2007. Return on average equity for the nine months ended September 30, 2008, was 11.09% compared with 13.40% for the nine months ended September 30, 2007.

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

Net interest income, the largest contributor to earnings, was \$16.32 million for the three months ended September 30, 2008, compared with \$17.14 million for the corresponding period in 2007, a decrease of \$820 thousand, or 4.78%.

Tax-equivalent net interest income totaled \$17.26 million for the three months ended September 30, 2008, a decrease of \$1.02 million from \$18.28 million for the third quarter of 2007. The decrease in net interest income was due primarily to decreases in loan and investment balances and those yields as a result of the precipitous declines in benchmark interest rates, including the New York Prime Rate, during the last nine months.

Compared with the third quarter of 2007, average earning assets decreased \$199.96 million while interest-bearing liabilities decreased \$124.63 million during the three months ended September 30, 2008. The yield on average earning assets decreased by 64 basis points to 6.22% from 6.86% between the three months ended September 30, 2008 and 2007, respectively. Total cost of interest-bearing liabilities decreased 105 basis points between the third quarters of 2007 and 2008, which resulted in a net interest rate spread that was 41 basis points higher at 3.64% for the third quarter of 2008 compared with 3.23% for the same period last year. The Company's tax-equivalent net interest margin of 3.90% for the three months ended September 30, 2008, increased 20 basis points from 3.70% for the same period of 2007.

The rate earned on loans decreased 95 basis points to 6.53% from 7.48% for the three months ended September 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 \$4.21 million, or 17.92%, in tax-equivalent loan interest income for the third quarter of 2008 compared with the third quarter of 2007.

-20-

---

**Table of Contents**

During the three months ended September 30, 2008, the tax-equivalent yield on available-for-sale securities decreased 21 basis points to 5.58%, while the average balance decreased by \$93.15 million, or 13.98%, 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 third quarter of 2007, average interest-bearing balances with banks decreased to \$1.44 million during the third quarter of 2008, as the yield decreased 228 basis points to 2.50% 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 third quarter 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 \$33.31 million, or 22.92%, while the average rate paid during the third quarter of 2008 decreased by 16 basis points.

During the three months ended September 30, 2008, the average balances of savings deposits decreased \$35.50 million, or 10.29%, while the average rate paid decreased 89 basis points compared to the same period in 2007. Average time deposits decreased \$66.14 million, or 9.47%, while the average rate paid on time deposits decreased 105 basis points from 4.47% in the third quarter of 2007 to 3.42% in the third quarter of 2008. Retail repurchase agreements, which consist of collateralized retail deposits and commercial treasury accounts, decreased \$23.65 million, or 13.62%, to \$149.98 million for the three months ended September 30, 2008, while the rate decreased 152 basis points to 1.94% during the same period. The level of average non-interest-bearing demand deposits decreased \$18.30 million, or 7.97%, to \$211.16 million during the quarter ended September 30, 2008, compared with the corresponding period of the prior year.

Compared with the same period in 2007, average federal funds purchased increased \$41.95 million to \$42.70 million during the third quarter of 2008. Average federal funds purchased increased as a \$50.00 million FHLB advance paying 3.64% was called in June 2008, and the Company borrowed overnight at a significant savings. Wholesale repurchase agreements remained unchanged at \$50.00 million, while the rate decreased 131 basis points between the two periods. The average balance of FHLB borrowings and other long-term debt decreased by \$74.61 million, or 25.60%, in the third quarter of 2008 to \$216.79 million, while the rate paid on those borrowings decreased 67 basis points.

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

Net interest income was \$49.31 million for the nine months ended September 30, 2008, compared with \$51.17 million for the corresponding period in 2007, a decrease of \$1.86 million, or 3.64%. Tax-equivalent net interest income totaled \$52.48 million for the nine months ended September 30, 2008, a decrease of \$2.05 million from \$54.53 million for the first nine months 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 benchmark interest rates, including the New York Prime Rate, during the last twelve months.

Compared with the first nine months of 2007, average earning assets decreased \$97.86 million while interest-bearing liabilities decreased \$39.46 million during the nine months ended September 30, 2008. The yield on average earning assets decreased by 52 basis points to 6.39% from 6.91% between the nine months ended September 30, 2008 and 2007, respectively. Total cost of interest-bearing liabilities decreased 74 basis points between the first nine months of 2007 and 2008, which resulted in a net interest rate spread that was 22 basis points higher at 3.54% for the first nine months of 2008 compared with 3.32% for the same period last year. The Company's tax-equivalent net interest margin of 3.87% for the nine months ended September 30, 2008, increased six basis points from 3.81% for the same period of 2007.

The rate earned on loans decreased 70 basis points to 6.80% from 7.50% for the nine months ended September 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 nine months of 2008. Declines in the average portfolio balances also contributed to a net decrease of \$9.99 million, or 14.18%, in tax-equivalent loan interest income for the first nine months of 2008 compared with the first nine months of 2007.

During the nine months ended September 30, 2008, the tax-equivalent yield on available-for-sale securities decreased 15 basis points to 5.61%, while the average balance decreased by \$6.97 million, or 1.14%, 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.

-21-

---



**Table of Contents**

Compared with the first nine months of 2007, average interest-bearing balances with banks decreased to \$12.36 million during the first nine months of 2008, as the yield decreased 202 basis points to 2.81% 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 nine months 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 \$25.38 million, or 17.35%, while the average rate paid during the first nine months of 2008 decreased 15 basis points. During the nine months ended September 30, 2008, average savings deposits decreased \$14.95 million, or 4.53%, while the rate paid was 1.63%, a 61 basis point decrease from the first nine months of 2007. Average time deposits decreased \$51.72 million, or 7.39%, while the average rate paid on time deposits decreased 63 basis points from 4.44% in the first nine months of 2007 to 3.81% in the first nine months of 2008. Retail repurchase agreements, which consist of collateralized retail deposits and commercial treasury accounts, decreased \$16.05 million, or 9.60%, to \$151.11 million for the nine months ended September 30, 2008, while the rate decreased 130 basis points to 2.25% during the same period. The level of average non-interest-bearing demand deposits decreased \$17.25 million, or 7.46%, to \$213.93 million during the nine months ended September 30, 2008, compared with the corresponding period of the prior year.

Compared with the same period in 2007, average federal funds purchased increased \$12.79 million to \$18.24 million during the first nine months of 2008, and wholesale repurchase agreements remained unchanged at \$50.00 million, while the rate decreased 153 basis points between the two periods. The average balance of FHLB borrowings and other long-term debt increased by \$5.09 million, or 2.06%, in the first nine months of 2008 to \$252.52 million, while the rate paid on those borrowings decreased 65 basis points. The Company prepaid a \$25.00 million FHLB advance during the first nine months 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.

-22-

---

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

	Three Months Ended September 30, 2008			Three Months Ended September 30, 2007		
	Average Balance	Interest (1)	Yield/ Rate (1)	Average Balance	Interest (1)	Yield/ Rate (1)
<i>(Dollars in Thousands)</i>						
<b>ASSETS</b>						
Earning Assets						
Loans (2)	\$ 1,174,855	\$ 19,286	6.53%	\$ 1,246,530	\$ 23,497	7.48%
Securities available for sale	573,046	8,035	5.58%	666,199	9,715	5.79%
Securities held to maturity	9,559	161	6.70%	12,591	254	8.00%
Interest-bearing deposits	1,435	9	2.50%	33,538	404	4.78%
Total Earning Assets	1,758,895	27,491	6.22%	1,958,858	33,870	6.86%
Other assets	242,296			212,178		
<b>TOTAL ASSETS</b>	<b>\$ 2,001,191</b>			<b>\$ 2,171,036</b>		
<b>LIABILITIES</b>						
Interest-bearing deposits:						
Demand deposits	\$ 178,632	\$ 73	0.16%	\$ 145,324	\$ 119	0.32%
Savings deposits	309,364	1,172	1.51%	344,866	2,088	2.40%
Time deposits	632,142	5,439	3.42%	698,280	7,876	4.47%
Total interest-bearing deposits	1,120,138	6,684	2.37%	1,188,470	10,083	3.37%
Borrowings:						
Federal funds purchased	42,702	251	2.34%	751	10	5.28%
Retail repurchase agreements	149,984	730	1.94%	173,630	1,516	3.46%
Wholesale repurchase agreements	50,000	389	3.10%	50,000	556	4.41%
FHLB borrowings and other indebtedness	216,789	2,173	3.99%	291,394	3,424	4.66%
Total borrowings	459,475	3,543	3.07%	515,775	5,506	4.24%
Total interest-bearing liabilities	1,579,613	10,227	2.58%	1,704,245	15,589	3.63%
Non-interestbearing						
demand deposits	211,155			229,452		
Other liabilities	17,680			19,920		
Stockholders Equity	192,743			218,049		

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 2,001,191	\$ 2,171,666	
Net Interest Income, Tax Equivalent	\$ 17,264	\$ 18,281	
Net Interest Rate Spread (3)		3.64%	3.23%
Net Interest Margin (4)		3.90%	3.70%

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

(2) Non-accrual  
loans are  
included in  
average  
balances  
outstanding but

with no related interest income during the period of non-accrual.

(3) Represents the difference between the yield on earning assets and cost of funds.

(4) Represents tax equivalent net interest income divided by average interest-earning assets.

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

	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007		
	Average Balance	Interest (1)	Yield/ Rate (1)	Average Balance	Interest (1)	Yield/ Rate (1)
<i>(Dollars in Thousands)</i>						
<b>ASSETS</b>						
Earning Assets						
Loans (2)	\$ 1,187,006	\$ 60,456	6.80%	\$ 1,255,209	\$ 70,445	7.50%
Securities available for sale	602,802	25,310	5.61%	609,772	26,267	5.76%
Securities held to maturity	10,849	675	8.31%	16,171	965	7.98%
Interest-bearing deposits	12,363	260	2.81%	29,726	1,073	4.83%
Total Earning Assets	1,813,020	86,701	6.39%	1,910,878	98,750	6.91%
Other assets	232,933			203,831		
<b>TOTAL ASSETS</b>	<b>\$ 2,045,953</b>			<b>\$ 2,114,709</b>		
<b>LIABILITIES</b>						
Interest-bearing deposits:						
Demand deposits	\$ 171,661	\$ 213	0.17%	\$ 146,283	\$ 349	0.32%
Savings deposits	314,903	3,847	1.63%	329,854	5,537	2.24%
Time deposits	648,282	18,483	3.81%	700,006	23,245	4.44%
Total interest-bearing deposits	1,134,846	22,543	2.65%	1,176,143	29,131	3.31%
Borrowings:						
Federal funds purchased	18,241	330	2.42%	5,447	229	5.62%
Retail repurchase agreements	151,107	2,540	2.25%	167,154	4,441	3.55%
Wholesale repurchase agreements	50,000	1,077	2.88%	50,000	1,651	4.41%
FHLB borrowings and other indebtedness	252,520	7,732	4.09%	247,428	8,773	4.74%
Total borrowings	471,868	11,679	3.31%	470,029	15,094	4.29%
Total interest-bearing liabilities	1,606,714	34,222	2.85%	1,646,172	44,225	3.59%
Non-interestbearing						
demand deposits	213,934			231,187		
Other liabilities	19,326			19,064		
Stockholders Equity	205,979			218,286		

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 2,045,953	\$ 2,114,709	
Net Interest Income, Tax Equivalent	\$ 52,479	\$ 54,525	
Net Interest Rate Spread (3)		3.54%	3.32%
Net Interest Margin (4)		3.87%	3.81%

(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.

-24-

---

**Table of Contents**

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 September 30, 2008 Compared to 2007</b>			<b>Nine Months Ended September 30, 2008 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)	\$ (1,314)	\$ (2,897)	\$ (4,211)	\$ (3,676)	\$ (6,313)	\$ (9,989)
Securities available-for-sale (1)	(1,337)	(343)	(1,680)	(291)	(666)	(957)
Securities held-to-maturity (1)	(55)	(38)	(93)	(332)	42	(290)
Interest-bearing deposits with other banks	(263)	(132)	(395)	(474)	(339)	(813)
<b>Total interest-earning assets</b>	<b>(2,969)</b>	<b>(3,410)</b>	<b>(6,379)</b>	<b>(4,773)</b>	<b>(7,276)</b>	<b>(12,049)</b>
Interest Paid On:						
Demand deposits	39	(85)	(46)	77	(213)	(136)
Savings deposits	(198)	(718)	(916)	(241)	(1,449)	(1,690)
Time deposits	(700)	(1,738)	(2,438)	(1,628)	(3,134)	(4,762)
Fed funds purchased	243	(2)	241	133	(32)	101
Retail repurchase agreements	(185)	(600)	(785)	(393)	(1,508)	(1,901)
Wholesale repurchase agreements		(167)	(167)		(574)	(574)
FHLB borrowings and other long-term debt	(799)	(452)	(1,251)	184	(1,225)	(1,041)
<b>Total interest-bearing liabilities</b>	<b>(1,600)</b>	<b>(3,762)</b>	<b>(5,362)</b>	<b>(1,868)</b>	<b>(8,135)</b>	<b>(10,003)</b>
<b>Change in net interest income, tax-equivalent</b>	<b>\$ (1,369)</b>	<b>\$ 352</b>	<b>\$ (1,017)</b>	<b>\$ (2,905)</b>	<b>\$ 859</b>	<b>\$ (2,046)</b>

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

**Provision and 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 nine months of 2008. Turmoil in the mortgage market adversely impacted both domestic and global markets, resulting in a 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.

-25-

---

**Table of Contents**

The allowance for loan losses was \$14.51 million at September 30, 2008, \$12.83 million at December 31, 2007 and \$13.19 million at September 30, 2007. The Company's allowance for loan loss activity for the three- and nine-month periods ended September 30, 2008 and 2007, is as follows:

<i>(In Thousands)</i>	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Allowance for loan losses</b>				
Beginning balance	\$ 13,433	\$ 13,934	\$ 12,833	\$ 14,549
Provision for loan losses	3,461		4,721	
Charge-offs	(2,601)	(1,009)	(4,765)	(2,813)
Recoveries	217	265	1,721	1,454
Net charge-offs	(2,384)	(744)	(3,044)	(1,359)
Ending balance	\$ 14,510	\$ 13,190	\$ 14,510	\$ 13,190

The total allowance for loan losses to loans held for investment ratio was 1.24% at September 30, 2008, compared with 1.05% at December 31, 2007, and 1.06% at September 30, 2007. Management considers the allowance adequate based upon its analysis of the portfolio as of September 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.

Throughout the third quarter and first nine months of 2008, the Company had net charge-offs of \$2.38 million and \$3.04 million, respectively, compared with \$744 thousand and \$1.36 million in the respective periods of 2007.

Annualized net charge-offs for the third quarter and first nine months of 2008 were 0.81% and 0.34%, respectively. The Company made provisions for loan losses of \$3.46 million and \$4.72 million for the third quarter and first nine months 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 third quarter of 2008 was \$7.88 million compared with \$6.02 million in the same period of 2007, an increase of \$1.86 million, or 30.95%. Wealth management revenues increased \$49 thousand, or 5.40%, to \$957 thousand for the three months ended September 30, 2008, compared with the same period in 2007. Service charges on deposit accounts increased \$802 thousand, or 26.68%, to \$3.81 million for the three months ended September 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 2007, which have positively impacted account service charges and new account openings. Other service charges, commissions, and fees increased \$138 thousand, or 15.30%, to \$1.04 million for the three months ended September 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 third quarter of 2008 were \$1.24 million. Other operating income was \$675 thousand for the three months ended September 30, 2008, a decrease of \$479 thousand, or 41.51%, compared with the same period in 2007. During the third quarter of 2008, securities gains of \$163 thousand were realized, compared with a gain of \$50 thousand in the comparable period in 2007.

Noninterest income for the first nine months of 2008 was \$24.75 million compared with \$16.78 million in the same period of 2007, an increase of \$7.97 million, or 47.47%. Wealth management revenues increased \$23 thousand, or 0.78%, to \$2.95 million for the nine months ended September 30, 2008, compared with the same period in 2007.

Wealth management revenues were slightly elevated in 2007 as the Trust Division settled several large estates. Service charges on deposit accounts increased \$2.29 million, or 28.39%, to \$10.37 million for the nine months ended September 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 2007, which have positively impacted account service charges and new account openings. Other service charges, commissions, and fees increased \$616 thousand, or 23.61%, to \$3.23 million for the nine months ended September 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 nine months of 2008 were \$3.73 million. Other operating income was \$2.34 million for the three months ended September 30, 2008, a decrease of \$620 thousand, or 20.97%, compared with the same period in 2007. During the first nine months of 2008, securities gains of \$2.13 million were realized compared with a gain of \$209 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.

-26-

---

**Table of Contents****Noninterest Expense**

Noninterest expense totaled \$14.44 million for the quarter ended September 30, 2008, an increase of \$1.61 million, or 12.50%, from the same period in 2007. Salaries and benefits for the first quarter of 2008 increased \$827 thousand, or 12.64%, compared to the same period in 2007. Salaries and benefits at GreenPoint accounted for \$687 thousand of the increase in the third quarter of 2008 over the prior third quarter. Increases in retirement plan accruals, incentive compensation accruals, and commissions expense made up the remainder of the increase. Other non-interest expense totaled \$4.68 million for the third quarter of 2008, an increase of \$273 thousand, or 6.19%, from \$4.41 million for the third 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 \$45.48 million for the nine months ended September 30, 2008, an increase of \$8.41 million, or 22.70%, from the same period in 2007. Salaries and benefits for the first nine months of 2008 increased \$3.62 million, or 18.94%, compared to the same period in 2007. Salaries and benefits at GreenPoint accounted for \$1.90 million of the increase in the first nine months 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 nine months 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 \$14.10 million for the first nine months of 2008, an increase of \$1.92 million, or 15.74%, from \$12.18 million for the first nine months 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.

In October 2008, the FDIC announced its intention to seek an increase in deposit insurance premiums that, beginning in 2009, would effectively double the average insurance premiums paid by depository institutions, such as the Bank, to ensure that the deposit insurance fund can adequately cover projected losses from future bank failures. At this time, the Company cannot provide any assurance as to the amount of any projected increase in its deposit insurance premium rate, should such an increase occur, as such changes are dependent upon a variety of factors, some of which are beyond the Company's control.

**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 third quarter of 2008, income taxes were \$1.75 million compared with \$3.01 million for the third quarter of 2007. For the quarters ended September 30, 2008 and 2007, the effective tax rates were 27.81% and 29.16%, respectively. For the nine months ended September 30, 2008, income taxes were \$6.75 million compared with \$9.01 million for the same period in 2007. For the nine months ended September 30, 2008 and 2007, the effective tax rates were 28.30% and 29.16%, respectively.

**FINANCIAL CONDITION**

Total assets at September 30, 2008, decreased \$182.38 million, or 8.48%, to \$1.97 billion from December 31, 2007. The decline reflects declining securities portfolio valuations, continued loan payoffs, and managed attrition of high-rate deposit, single-service households.

**Securities**

Available-for-sale securities were \$513.00 million at September 30, 2008, compared with \$664.12 million at December 31, 2007, a decrease of \$151.12 million, or 22.75%. Held-to-maturity securities declined to \$9.04 million at September 30, 2008, compared with \$12.08 million at December 31, 2007.

For a more detailed discussion of the Company's investment portfolio, refer to footnote 3 to the September 30, 2008, financial statements in Part 1, Item 1 of this Quarterly Report on Form 10-Q.

-27-

---

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

**Loans Held for Sale:** The \$140 thousand balance of loans held for sale at September 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 September 30, 2008, was \$4.36 million on 33 loans.

**Loans Held for Investment:** Total loans held for investment were \$1.17 billion at September 30, 2008, representing declines of \$57.22 million and \$70.92 million from December 31 and September 30, 2007, respectively. The average loan to deposit ratio decreased to 88.25% for the third quarter of 2008, compared with 88.49% for the fourth quarter of 2007 and 87.91% for the third quarter of 2007. Year-to-date average loans of \$1.19 billion decreased \$68.20 million when compared with the first nine months of 2007 average of \$1.26 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 a reduced complement 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 September 30, 2008, December 31, 2007, and September 30, 2007.

<i>(Dollars in Thousands)</i>	<b>September 30, 2008</b>		<b>December 31, 2007</b>		<b>September 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	\$ 83,271	7.13%	\$ 96,261	7.85%	\$ 94,168	7.60%
Commercial real estate	386,287	33.06%	386,112	31.51%	396,147	31.97%
Residential real estate	498,721	42.69%	498,345	40.66%	500,760	40.41%
Construction	127,076	10.88%	163,310	13.33%	167,089	13.48%
Consumer	66,333	5.68%	75,447	6.16%	77,724	6.27%
Other	6,598	0.56%	6,027	0.49%	3,319	0.27%
<b>Total</b>	<b>\$ 1,168,286</b>	<b>100.00%</b>	<b>\$ 1,225,502</b>	<b>100.00%</b>	<b>\$ 1,239,207</b>	<b>100.00%</b>
<b>Loans Held for Sale</b>	<b>\$ 140</b>		<b>\$ 811</b>		<b>\$ 2,294</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 \$7.89 million at September 30, 2008, \$3.47 million at December 31, 2007, and \$3.08 million at September 30, 2007. The increase in non-performing assets stems largely from the addition of one loan relationship in the Richmond, Virginia, 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 0.68% at September 30, 2008, 0.28% at December 31, 2007, and 0.25% at September 30, 2007.

**Table of Contents**

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

<i>(In Thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>	<b>September 30, 2007</b>
Non-accrual	\$ 6,997	\$ 2,923	\$ 2,869
Ninety days past due and accruing			
Other real estate owned	896	545	211
Total non-performing assets	\$ 7,893	\$ 3,468	\$ 3,080

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 \$896 thousand at September 30, 2008, and is carried at the lesser of estimated net realizable value or cost.

**Deposits and Other Borrowings**

Total deposits decreased by \$43.90 million, or 3.15%, during the first nine months of 2008. Non interest-bearing demand deposits decreased \$9.51 million to \$214.58 million at September 30, 2008, compared with \$224.09 million at December 31, 2007. Interest-bearing demand deposits increased \$32.83 million to \$186.40 million at September 30, 2008. Savings decreased \$15.24 million, or 4.65%, and time deposits decreased \$51.99 million, or 7.56%, during the first nine months of 2008. Throughout most of the last twelve months, the Company has aggressively lowered money market and certificate of deposit rates, which is the primary cause of the decreases in deposits.

Securities sold under repurchase agreements decreased \$27.04 million, or 13.04%, in the first nine months of 2008 to \$180.39 million. There were \$29.50 million in federal funds purchased outstanding at September 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 \$46.29 million, or 21.32%, from \$217.10 million at December 31, 2007, to \$170.81 million at September 30, 2008, as the Company pursued its stock repurchase program and experienced increases in other comprehensive losses associated with the Company's investment portfolio. The change in equity was the result of net earnings of \$17.10 million, less dividends paid to stockholders of \$9.23 million, common stock repurchases of \$4.22 million, and other comprehensive loss of \$50.12 million.

The Company repurchased 132,100 shares of its common stock in the first nine months 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 September 30, 2008, the Company's total capital to risk-weighted assets ratio was 13.30% compared with 12.34% at December 31, 2007. The Company's Tier 1 capital to risk-weighted assets ratio was 12.23% at September 30, 2008, compared with 11.45% at December 31, 2007. The Company's Tier 1 leverage ratio at September 30, 2008, was 8.68% compared with 8.09% at December 31, 2007. All of the Company's regulatory capital ratios exceed the current well-capitalized levels.

**Table of Contents**

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

**Liquidity and Capital Resources**

At September 30, 2008, the Company maintained liquidity in the form of cash and cash equivalent balances of \$53.24 million, unpledged securities available-for-sale of \$141.27 million, and total FHLB credit availability of approximately \$57.89 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. At September 20, 2008, net interest income modeling shows the Company to be in a slightly asset-sensitive position. Additionally, structure in the Company's assets and liabilities creates a situation where net interest income decreases in a sustained increasing rate environment.

-30-

---

**Table of Contents**

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 September 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)*

Increase (Decrease) in Interest Rates (Basis Points)	September 30, 2008			
	Change in Net Interest Income	% Change	Change in Economic Value of Equity	% Change
200	\$ (1,051)	(1.5)	\$ (21,155)	(8.6)
100	967	1.4	954	0.4
(100)	(1,523)	(2.2)	(10,705)	(4.4)
(200)	(4,379)	(6.4)	(34,456)	(14.0)

  

Increase (Decrease) in Interest Rates (Basis Points)	December 31, 2007			
	Change in Net Interest Income	% Change	Change in Economic Value of Equity	% Change
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)

-31-

**Table of Contents**

**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 September 30, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

**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**

Except for the risk factor set forth below, 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.

***Declines in asset values may result in impairment charges and adversely impact the value of our investments***

The Company maintains an investment portfolio, which includes trust-preferred securities. At September 30, 2008, the total market value of these trust-preferred securities was approximately \$87.52 million, compared with an adjusted cost basis of approximately \$164.20 million. The decline in market value of these securities is primarily due to the credit market disruptions in bank subordinated debt instruments, credit rating downgrades and the possibility of future negative credit events within the banking sector. The Company periodically, but not less than quarterly, evaluates its investments and other assets for impairment indicators. In the event that the Company is required to record impairment charges for its investments due to a decline in value that is considered other-than-temporarily impaired, it could have a material adverse affect on the Company's results of operations and a non-cash impact on funds from operations in the period in which the write-down occurs.

**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 September 30, 2008.

	<b>Total # of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plan</b>	<b>Maximum Number of Shares That May Yet be Purchased Under the Plan</b>
July 1-31, 2008	4,000	\$ 27.60	4,000	551,060
August 1-31, 2008				562,493
September 1-30, 2008				568,579
Total	4,000	\$	4,000	

The Company's stock repurchase plan allows for the purchase and retention of up to 1,100,000 shares. The plan has no expiration date and remains open. The Company held 531,421 shares in treasury at September 30, 2008.

**ITEM 3. Defaults Upon Senior Securities**

Not Applicable

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

Not Applicable

**Table of Contents**

**ITEM 5. Other Information**

Not Applicable

**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.

**Table of Contents**

- (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.
  
- (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.

**Table of Contents**

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: November 10, 2008

/s/ John M. Mendez

John M. Mendez

President & Chief Executive Officer

(Principal Executive Officer)

DATE: November 10, 2008

/s/ David D. Brown

David D. Brown

Chief Financial Officer

(Principal Accounting Officer)

-36-

---

**Table of Contents**

**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

-37-