

FIRST COMMUNITY BANCSHARES INC /NV/

Form 10-K

March 13, 2009

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934**

**For the fiscal year ended December 31, 2008**

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

**Nevada**  
*(State or other jurisdiction of incorporation)*  
**P.O. Box 989**  
**Bluefield, Virginia**  
*(Address of principal executive offices)*

**55-0694814**  
*(I.R.S. Employer Identification No.)*  
**24605-0989**  
*(Zip Code)*

**(276) 326-9000**

*Registrant's telephone number, including area code:*

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of exchange on which registered</b>
<b>Common Stock, \$1.00 par value</b>	<b>NASDAQ Global Select</b>

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.  Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.  Yes  No

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

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Approximately \$258.21 million based on the closing sales price at June 30, 2008.

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

Class Common Stock, \$1.00 Par Value; 11,567,449 shares outstanding as of March 2, 2009

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the annual meeting of shareholders to be held April 28, 2009, are incorporated by reference in Part III of this Form 10-K.

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## TABLE OF CONTENTS

		Page
<b><u>PART I</u></b>		
<u>Item 1</u>	<u>Business</u>	3
<u>Item 1A</u>	<u>Risk Factors</u>	12
<u>Item 1B</u>	<u>Unresolved Staff Comments</u>	17
<u>Item 2</u>	<u>Properties</u>	17
<u>Item 3</u>	<u>Legal Proceedings</u>	17
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>	17
<b><u>PART II</u></b>		
<u>Item 5</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	17
<u>Item 6</u>	<u>Selected Financial Data</u>	20
<u>Item 7</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	21
<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
<u>Item 8</u>	<u>Financial Statements and Supplementary Data</u>	46
<u>Item 9</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	90
<u>Item 9A</u>	<u>Controls and Procedures</u>	90
<u>Item 9B</u>	<u>Other Information</u>	90
<b><u>PART III</u></b>		
<u>Item 10</u>	<u>Directors, Executive Officers and Corporate Governance</u>	90
<u>Item 11</u>	<u>Executive Compensation</u>	92
<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	92
<u>Item 13</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	93
<u>Item 14</u>	<u>Principal Accounting Fees and Services</u>	93
<b><u>PART IV</u></b>		
<u>Item 15</u>	<u>Exhibits, Financial Statement Schedules</u>	93
	<u>Signatures</u>	96
<u>EX-12</u>		
<u>EX-23.1</u>		
<u>EX-31.1</u>		
<u>EX-31.2</u>		
<u>EX-32</u>		

**Table of Contents**

**PART I**

**ITEM 1. BUSINESS.**

**General**

First Community Bancshares, Inc. (the *Company*) is a bank holding company incorporated in the State of Nevada and serves as the holding company for First Community Bank, N. A. (the *Bank*), a national banking association that conducts commercial banking operations within the states of Virginia, West Virginia, North and South Carolina, and Tennessee. The Company also owns GreenPoint Insurance Group, Inc. (*GreenPoint*), a full-service insurance agency acquired in September 2007, and Investment Planning Consultants (*IPC*), an investment advisory. The Company had total consolidated assets of approximately \$2.13 billion at December 31, 2008, and conducts its banking operations through fifty-nine locations.

The Company provides a mechanism for ownership of the subsidiary banking operations, provides capital funds as required, and serves as a conduit for distribution of dividends to stockholders. The Company's banking operations are expected to remain the principal business and major source of revenue for the Company. The Company also considers and evaluates options for growth and expansion of the existing subsidiary banking operations. The Company currently derives substantially all of its revenues from dividends paid by its subsidiary bank. Dividend payments by the Bank are determined in relation to earnings, asset growth and capital position and are subject to certain restrictions by regulatory agencies as described more fully under *Regulation and Supervision* of this item.

**Employees**

The Company and its subsidiaries employed 638 full-time equivalent employees at December 31, 2008. Management considers employee relations to be excellent.

**Regulation and Supervision**

***General***

The supervision and regulation of the Company and its subsidiaries by the banking agencies is intended primarily for the protection of depositors, the deposit insurance fund of the Federal Deposit Insurance Corporation (*FDIC*), and the banking system as a whole, and not for the protection of stockholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks, including the power to impose substantial fines and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and the Bank are subject. References in the following description to applicable statutes and regulations are brief summaries of these statutes and regulations, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

***The Company***

The Company is a financial holding company pursuant to the Gramm-Leach-Bliley Act (*GLB Act*) and a bank holding company registered under the Bank Holding Company Act of 1956, as amended (*BHCA*). Accordingly, the Company is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System

( Federal Reserve Board ). The BHCA, the GLB Act, and other federal laws subject financial and bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

*Regulatory Restrictions on Dividends; Source of Strength.* It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only from income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial

## **Table of Contents**

condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

Furthermore, under the Treasury's Capital Purchase Program, the Company must obtain the Treasury's consent for any increase in dividends declared on its common stock. This restriction applies until the third anniversary of the investment by the Treasury, unless prior to that time the Company redeems the Series A Preferred Stock that it issued to the Treasury or the Treasury transfers the Series A Preferred Stock to a third party.

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. Such support may be required at times when, absent this Federal Reserve Board policy, a holding company may not be inclined to provide it. As discussed below, a bank holding company in certain circumstances could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

*Scope of Permissible Activities.* Under the BHCA, bank holding companies generally may not acquire a direct or indirect interest in or control of more than 5% of the voting shares of any company that is not a bank or bank holding company or from engaging in activities other than those of banking, managing or controlling banks or furnishing services to or performing services for its subsidiaries, except that it may engage in, directly or indirectly, certain activities that the Federal Reserve Board determined to be closely related to banking or managing and controlling banks as to be a proper incident thereto.

Notwithstanding the foregoing, the GLB Act, effective March 11, 2000, eliminated the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers and permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The GLB Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities and activities that the Federal Reserve Board has determined to be closely related to banking. No regulatory approval is generally required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

Under the GLB Act, a bank holding company may become a financial holding company by filing a declaration with the Federal Reserve Board if each of its subsidiary banks is well-capitalized under the Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ) prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act of 1977 ( CRA ). The Company elected financial holding company status in December 2006.

*Safe and Sound Banking Practices.* Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution.

*Anti-Tying Restrictions.* Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates.

*Stock Repurchases.* A bank holding company is required to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated

net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation.

The Company's ability to repurchase its shares also is restricted under the terms of the Purchase Agreement. The Treasury's consent is generally required for the Company to make any stock repurchases until the third anniversary of the investment by the Treasury unless prior to that time the Company redeems the Series A Preferred Stock that it issued to the Treasury or the Treasury transfers the Series A Preferred Stock to a third party. Further,



## **Table of Contents**

common, junior preferred or *pari passu* preferred shares may not be repurchased if the Company is in arrears on the Series A Preferred Stock dividends.

*Capital Adequacy Requirements.* The Federal Reserve Board has promulgated capital adequacy guidelines for use in its examination and supervision of bank holding companies. If a bank holding company's capital falls below minimum required levels, then the bank holding company must implement a plan to increase its capital, and its ability to pay dividends, make acquisitions of new banks or engage in certain other activities such as issuing brokered deposits may be restricted or prohibited.

The Federal Reserve Board currently uses two types of capital adequacy guidelines for holding companies, a two-tiered risk-based capital guideline and a leverage capital ratio guideline. The two-tiered risk-based capital guideline assigns risk weightings to all assets and certain off-balance sheet items of the holding company's operations, and then establishes a minimum ratio of the holding company's Tier 1 capital to the aggregate dollar amount of risk-weighted assets (which amount is usually less than the aggregate dollar amount of such assets without risk weighting) and a minimum ratio of the holding company's total capital (Tier 1 capital plus Tier 2 capital, as adjusted) to the aggregate dollar amount of such risk-weighted assets. The leverage ratio guideline establishes a minimum ratio of the holding company's Tier 1 capital to its total tangible assets (total assets less goodwill and certain identifiable intangibles), without risk-weighting.

Under both guidelines, Tier 1 capital (sometimes referred to as core capital) is defined to include: common shareholders' equity (including retained earnings), qualifying non-cumulative perpetual preferred stock and related surplus, qualifying cumulative perpetual preferred stock and related surplus, trust preferred securities, and minority interests in the equity accounts of consolidated subsidiaries (limited to a maximum of 25% of Tier 1 capital). Goodwill and most intangible assets are deducted from Tier 1 capital. For purposes of the total risk-based capital guidelines, Tier 2 capital (sometimes referred to as supplementary capital) is defined to include: allowances for loan and lease losses (limited to 1.25% of risk-weighted assets), perpetual preferred stock not included in Tier 1 capital, intermediate-term preferred stock and any related surplus, certain hybrid capital instruments, perpetual debt and mandatory convertible debt securities, and intermediate-term subordinated debt instruments (subject to limitations). The maximum amount of qualifying Tier 2 capital is 100% of qualifying Tier 1 capital. For purposes of the total capital guideline, total capital equals Tier 1 capital, *plus* qualifying Tier 2 capital, *minus* investments in unconsolidated subsidiaries, reciprocal holdings of bank holding company capital securities, and deferred tax assets and other deductions. The Federal Reserve Board's current capital adequacy guidelines require that a bank holding company maintain a Tier 1 risk-based capital ratio of at least 4% and a total risk-based capital ratio of at least 8%. At December 31, 2008, the Company's ratio of Tier 1 capital to total risk-weighted assets was 11.92% and its ratio of total capital to risk-weighted assets was 12.91%.

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of 4.0% or more, depending on their overall condition. At December 31, 2008, the Company's leverage ratio was 9.75%.

The federal banking agencies' risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on

intangible assets.

*Acquisitions by Bank Holding Companies.* The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding

## **Table of Contents**

companies, the Federal Reserve Board is required to consider the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors.

### ***The Bank***

The Bank is a national association and is subject to supervision and regulation by the Office of the Comptroller of Currency ( OCC ). Since the deposits of the Bank are insured by the FDIC, the Bank is also subject to supervision and regulation by the FDIC. Because the Federal Reserve Board regulates the Company, and because the Bank is a member of the Federal Reserve System, the Federal Reserve Board also has regulatory authority which directly affects the Bank.

*Restrictions on Transactions with Affiliates and Insiders.* Transactions between the Bank and its nonbanking subsidiaries and/or affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act. In general, Section 23A imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Company or its subsidiaries.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve Board has issued Regulation W which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to such persons. These loans cannot exceed the institution's total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate.

*Restrictions on Distribution of Subsidiary Bank Dividends and Assets.* Dividends paid by the Bank have provided the Company's operating funds and for the foreseeable future it is anticipated that dividends paid by the Bank to the Company will continue to be the Company's primary source of operating funds.

Capital adequacy requirements of the OCC limit the amount of dividends that may be paid by the Bank. The Bank cannot pay a dividend if, after paying the dividend, it would be classified as undercapitalized. In addition, without the OCC's approval, dividends may not be paid by the Bank in an amount in any calendar year which exceeds its total net profits for that year, plus its retained profits for the preceding two years, less any required transfers to capital surplus. National banks also may not pay dividends in excess of total retained profits, including current year's earnings after deducting bad debts in excess of reserves for loan losses. In some cases, the OCC may find a dividend payment that meets these statutory requirements to be an unsafe or unsound practice.

Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary's liquidation or reorganization will be subject to the prior claims of the subsidiary's creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository institution holding company or any shareholder or creditor thereof.

*Examinations.* Under the FDICIA, all insured institutions must undergo regular on-site examination by their appropriate banking agency and such agency may assess the institution for its costs of conducting the examination. The OCC periodically examines and evaluates national banks, such as the Bank. These examinations review areas such as capital adequacy, reserves, loan portfolio quality and management, consumer and other compliance issues, investments, information systems, disaster recovery and contingency planning and management practices. Based upon such an evaluation, the OCC may revalue the assets of a bank and require that it establish specific reserves to compensate for the difference between the OCC-determined value and the book value of such assets.

## **Table of Contents**

*Capital Adequacy Requirements.* The OCC has adopted regulations establishing minimum requirements for the capital adequacy of insured national banks. The OCC may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The OCC's risk-based capital guidelines generally require national banks to have a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for the Bank as for the Company. At December 31, 2008, the Bank's ratio of Tier 1 capital to total risk-weighted assets was 10.69% and its ratio of total capital to total risk-weighted assets was 11.69%.

The OCC's leverage guidelines require national banks to maintain Tier 1 capital of no less than 4.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets. At December 31, 2008, the Bank's leverage ratio was 8.71%.

*Corrective Measures for Capital Deficiencies.* The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A well-capitalized bank has a total risk-based capital ratio of 10.0% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An adequately capitalized bank has a total risk-based capital ratio of 8.0% or higher; a Tier 1 risk-based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well-capitalized bank. A bank is undercapitalized if it fails to meet any one of the ratios required to be adequately capitalized. The Bank is classified as well-capitalized for purposes of the FDIC's prompt corrective action regulations.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution's capital decreases, the federal regulators' enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The FDIC has limited discretion in dealing with a critically undercapitalized institution and is generally required to appoint a receiver or conservator. Similarly, within 90 days of a national bank becoming critically undercapitalized, the OCC must appoint a receiver or conservator unless certain findings are made with respect to the institution's continued viability.

Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

*Deposit Insurance Assessments.* The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system to evaluate the risk of each financial institution based on three primary sources of information: (1) its supervisory rating, (2) its financial ratios, and (3) its long-term debt issuer rating, if the institution has one. The FDIC also adopted a new base schedule of rates that it can adjust up or down, depending on the needs of the DIF, and set premiums for 2008 that range from 5 basis points in the lowest risk category to 43 basis points for

banks in the highest risk category.

In an effort to restore capitalization levels and to ensure the DIF will adequately cover projected losses from future bank failures, the FDIC, in October 2008, proposed a rule to alter the way in which it differentiates for risk in the risk-based assessment system and to revise deposit insurance assessment rates, including base assessment rates.

## **Table of Contents**

The FDIC also proposes to introduce three adjustments that could be made to an institution's initial base assessment rate, including (i) a potential decrease of up to 2 basis points for long-term unsecured debt, including senior and subordinated debt, (ii) a potential increase for secured liabilities in excess of 15% of domestic deposits and (iii) a potential increase for brokered deposits in excess of 10% of domestic deposits. In addition, the FDIC proposed raising the current rates uniformly by 7 basis points for the assessment for the first quarter of 2009 resulting in a minimum annualized assessment rate of 12 basis points. The proposal for first quarter 2009 assessment rates was adopted as a final rule in December 2008. The FDIC also proposed, effective April 1, 2009, an initial minimum base assessment rate of 10 basis points. A final rule related to this proposal is expected to be issued during the first quarter of 2009. The Company cannot provide any assurance as to the amount of any proposed 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.

FDIC insurance expense totaled \$202 thousand and \$164 thousand in 2008 and 2007, respectively. FDIC insurance expense includes deposit insurance assessments and Financing Corporation ( FICO ) assessments related to outstanding FICO bonds. The FICO is a mixed-ownership government corporation established by the Competitive Equality Banking Act of 1987 whose sole purpose was to function as a financing vehicle for the now defunct Federal Savings & Loan Insurance Corporation. Under the Federal Deposit Insurance Reform Act of 2005, the Bank received a one-time assessment credit of \$1.13 million to be applied against future deposit insurance assessments, subject to certain limitations. This credit was utilized to offset \$693 thousand and \$356 thousand of deposit insurance assessments during 2008 and 2007, respectively.

On February 26, 2009, the FDIC adopted an interim rule, with request for comment, to impose a one-time 20 basis point emergency special assessment effective on June 30, 2009 and to be collected on September 30, 2009. Based on the Company's most recent FDIC deposit insurance assessment base, the emergency special assessment of 20 basis points, if implemented, would increase our FDIC deposit insurance premiums by approximately \$2.87 million in 2009. The FDIC has indicated that it may consider reducing the emergency special assessment by half to 10 basis points if, among other factors, Congress enacts legislation to expand the FDIC's line of credit with the Treasury.

On February 26, 2009, the FDIC adopted another interim rule, with request for comment, to have the option to impose a further special assessment of up to 10 basis points on an institution's assessment base on the last day of any calendar quarter after June 30, 2009 to be collected at the same time the risk-based assessments are collected. The assessment will be imposed if the FDIC determines the DIF reserve ratio will fall to a level that would adversely affect public confidence or to a level close to zero or negative, among other factors. These interim rules are subject to change and may or may not be enacted.

The Company cannot provide any assurance as to the amount of any proposed increase in its deposit insurance premium rate, as such changes are dependent upon a variety of factors, some of which are beyond the Company's control. Given the enacted and proposed increases in assessments for insured financial institutions in 2009, the Company anticipates that FDIC assessments on deposits will have a significantly greater impact upon operating expenses in 2009 compared to 2008, and could affect its reported earnings, liquidity and capital for the period.

Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

*Temporary Liquidity Guarantee Program.* In November 2008, the FDIC adopted a final rule relating to the Temporary Liquidity Guarantee Program ( TLG Program ). Under the TLG Program, the FDIC will (i) guarantee, through the earlier of maturity or June 30, 2012, certain newly issued senior unsecured debt issued by participating institutions on or after October 14, 2008, and before June 30, 2009 and (ii) provide full FDIC deposit insurance

coverage for non-interest bearing transaction deposit accounts, Negotiable Order of Withdrawal ( NOW ) accounts paying less than 0.5% interest per annum and Interest on Lawyers Trust Accounts held at participating FDIC-insured institutions through December 31, 2009. Coverage under the TLG Program was available for the first 30 days without charge. The fee assessment for coverage of senior unsecured debt ranges from 50 basis points to 100 basis points per annum, depending on the initial maturity of the debt. The fee assessment for deposit insurance



**Table of Contents**

coverage is 10 basis points per quarter on amounts in covered accounts exceeding \$250,000. In December 2008, the Company elected to participate in both guarantee programs.

*Enforcement Powers.* The FDIC and the other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Company or the Bank, as well as officers, directors and other institution-affiliated parties of these organizations, to administrative sanctions and potentially substantial civil money penalties. The appropriate federal banking agency may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the banking institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized; fails to become adequately capitalized when required to do so; fails to submit a timely and acceptable capital restoration plan; or materially fails to implement an accepted capital restoration plan.

*Emergency Economic Stabilization Act of 2008.* On October 3, 2008, the President signed into law EESA, which, among other measures, authorized the Secretary of the Treasury to establish the TARP. Pursuant to TARP, the Treasury has the authority to, among other things, 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. In addition, under TARP, the Treasury created the Capital Purchase Plan, pursuant to which it provides access to capital that will serve as Tier 1 capital to financial institutions through a standardized program to acquire preferred stock (accompanied by warrants) from eligible financial institutions. On November 21, 2008, the Company sold \$41.50 million of Series A Preferred Stock to the Treasury under the Capital Purchase Program.

On February 17, 2009, the President signed into law the ARRA, which is intended, among other things, to provide a stimulus to the U.S. economy in the wake of the economic downturn brought about by the subprime mortgage crisis and the resulting dislocations in the financial markets. ARRA also includes numerous non-economic recovery related items, including a limitation on executive compensation of certain of the most highly-compensated employees and executive officers of financial institutions, such as the Company, that participated in the TARP Capital Purchase Program. Compliance requirements under ARRA for TARP recipients, which will be further described in rules to be adopted by the SEC and standards to be established by the Treasury, include restrictions on executive compensation and corporate governance requirements.

*Comprehensive Financial Stability Plan of 2009.* On February 10, 2009, the Secretary of the Treasury announced a new comprehensive financial stability plan (the Financial Stability Plan), which builds upon existing programs and earmarks the second \$350 billion of unused funds originally authorized under the EESA. The major elements of the Financial Stability Plan include: (i) a capital assistance program that will invest in convertible preferred stock of certain qualifying institutions, (ii) a consumer and business lending initiative to fund new consumer loans, small business loans and commercial mortgage asset-backed securities issuances, (iii) a new public-private investment fund that will leverage public and private capital with public financing to purchase up to \$500 billion to \$1 trillion of legacy toxic assets from financial institutions, and (iv) assistance for homeowners to reduce mortgage payments and interest rates and establishing loan modification guidelines for government and private programs. In addition, all banking institutions with assets over \$100 billion will be required to undergo a comprehensive stress test to determine if they have sufficient capital to continue lending and to absorb losses that could result from a more severe decline in the economy than projected. Institutions receiving assistance under the Financial Stability Plan going forward will be subject to higher transparency and accountability standards, including restrictions on dividends, acquisitions and executive compensation and additional disclosure requirements.

*Consumer Laws and Regulations.* In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, and the Fair Housing Act, and various state counterparts. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers

## **Table of Contents**

when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

In addition, federal law currently contains extensive customer privacy protection provisions. Under these provisions, a financial institution must provide to its customers, at the inception of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These provisions also provide that, except for certain limited exceptions, a financial institution may not provide such personal information to unaffiliated third parties unless the institution discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure.

*USA PATRIOT Act of 2001.* The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ( Patriot Act ) was enacted in October 2001. The Patriot Act has broadened existing anti-money laundering legislation while imposing new compliance and due diligence obligations on banks and other financial institutions, with a particular focus on detecting and reporting money laundering transactions involving domestic or international customers. The U.S. Treasury Department has issued and will continue to issue regulations clarifying the Patriot Act's requirements. The Patriot Act requires all financial institutions, as defined, to establish certain anti-money laundering compliance and due diligence programs. Recently, the regulatory agencies have intensified their examination procedures in light of the Patriot Act's anti-money laundering and Bank Secrecy Act requirements. The Company believes that its controls and procedures are in compliance with the Patriot Act.

## **Troubled Asset Relief Program**

On November 21, 2008, the Company entered into a Letter Agreement, which incorporates by reference the Securities Purchase Agreement Standard Terms (the Purchase Agreement ), with the U.S. Department of the Treasury ( Treasury ). Pursuant to the terms of the Purchase Agreement, the Company issued and sold to the Treasury (i) 41,500 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock ) and (ii) a warrant (the Warrant ) to purchase 176,546 shares of the Company's common stock, par value \$1.00 per share (the Common Stock ), for an aggregate purchase price of \$41.50 million in cash.

The Series A Preferred Stock qualifies as Tier 1 capital and will pay cumulative dividends at a rate of 5.00% per annum for the first five years, and 9.00% per annum thereafter. The Series A Preferred Stock is generally non-voting. The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an initial per share exercise price of \$35.26. Pursuant to the Purchase Agreement, Treasury has agreed not to exercise voting power with respect to any share of Common Stock issued upon exercise of the Warrant.

The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. In accordance with the terms of the Purchase Agreement, the Company registered the Series A Preferred Stock, the Warrant, and the shares of Common Stock underlying the Warrant with the Securities and Exchange Commission (the SEC ). Neither the Series A Preferred Stock nor the Warrant are subject to any contractual restrictions on transfer, except that Treasury may only transfer or exercise one-half of the Warrant Shares prior to the earlier of the redemption of 100% of the Series A Preferred Stock and December 31, 2009.

Pursuant to the terms of the Purchase Agreement, upon issuance of the Series A Preferred Stock, the ability of the Company to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Common Stock is subject to restrictions, including a restriction against increasing cash dividends above the amount of the last quarter cash dividend per share declared prior to October 14, 2008, which was \$0.28 per share, without express permission of the Treasury. These restrictions will terminate on the earlier of (a) the third anniversary

date of the Series A Preferred Stock and (b) the date on which the Series A Preferred Stock has been redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock to third parties.

In the Purchase Agreement, the Company agreed that, until such time as Treasury ceases to own any debt or equity securities of the Company acquired pursuant to the Purchase Agreement, the Company will take all

## **Table of Contents**

necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the EESA ) as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series A Preferred Stock and the Warrant, and has agreed to not adopt any benefit plans with respect to, or which covers, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the ARRA ) was signed into law. Section 7001 of the ARRA amended Section 111 of the EESA in its entirety. While the Treasury must promulgate regulations to implement the restrictions and standards set forth in Section 7001, the ARRA, among other things, significantly expands the executive compensation restrictions previously imposed by the EESA. Such restrictions apply to any entity that has received or will receive financial assistance under the Troubled Asset Recovery Program ( TARP ), and will generally continue to apply for as long as any obligation arising from financial assistance provided under TARP, including preferred stock issued under the Capital Purchase Program, remains outstanding. As a result of the Company s participation in the Capital Purchase Program, the restrictions and standards set forth in Section 7001 of the ARRA are applicable to the Company. In addition, Section 7001(g) of the ARRA, provides that the Secretary of the Treasury shall permit, subject to appropriate federal banking agency approval, a TARP recipient to repay such assistance previously provided under the TARP, without regard to whether the recipient has replaced such funds from any other source or to any waiting period. ARRA further provides that when the TARP recipient repays such assistance, the Secretary of the Treasury shall liquidate the warrants associated with the assistance at the current market price.

## **Website Access to Company Documents**

The Company makes available free of charge on its website at [www.fcbin.com](http://www.fcbin.com) its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and all amendments thereto, as soon as reasonably practicable after the Company files such reports with, or furnishes them to, the SEC. Investors are encouraged to access these reports and the other information about the Company s business on its website. Information found on the Company s website is not part of this Annual Report on Form 10-K. The Company will also provide copies of its Annual Report on Form 10-K, free of charge, upon written request of its Investor Relations Department at the Company s main address, P.O. Box 989, Bluefield, VA 24605.

Also posted on the Company s website, and available in print upon request of any shareholder to our Investor Relations Department, are the charters of the standing committees of its Board of Directors, the Standards of Conduct governing our directors, officers, and employees, and the Company s Insider Trading & Disclosure Policy.

## **Forward-Looking Statements**

This Annual Report on Form 10-K may include forward-looking statements , 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 and similar words 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 Federal Reserve Board; 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

## **Table of Contents**

noninterest 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 all-inclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, then the Company's actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Annual Report on Form 10-K. Therefore, the Company cautions you not to place undue reliance on these forward-looking statements.

The Company does not intend to update these forward-looking statements, whether written or oral, to reflect change. All forward-looking statements attributable to the Company are expressly qualified by these cautionary statements.

### **ITEM 1A. RISK FACTORS.**

#### ***The current economic environment poses significant challenges for the Company and could adversely affect its financial condition and results of operations.***

The Company is operating in a challenging and uncertain economic environment, including generally uncertain national and local conditions. Financial institutions continue to be affected by sharp declines in the real estate market and constrained financial markets. Dramatic declines in the housing market over the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions. Continued declines in real estate values, home sales volumes, and financial stress on borrowers as a result of the uncertain economic environment could have an adverse effect on the Company's borrowers or their customers, which could adversely affect the Company's financial condition and results of operations. A worsening of these conditions would likely exacerbate the adverse effects on the Company and others in the financial institutions industry. For example, further deterioration in local economic conditions in the Company's markets could drive losses beyond that which is provided for in its allowance for loan losses. The Company may also face the following risks in connection with these events:

Economic conditions that negatively affect housing prices and the job market have resulted, and may continue to result, in a deterioration in credit quality of the Company's loan portfolios, and such deterioration in credit quality has had, and could continue to have, a negative impact on the Company's business.

Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities.

The processes the Company uses to estimate allowance for loan losses and reserves may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation.

The Company's ability to assess the creditworthiness of its customers may be impaired if the models and approaches it uses to select, manage, and underwrite its customers become less predictive of future charge-offs.

The Company expects to face increased regulation of its industry, and compliance with such regulation may increase our costs, limit our ability to pursue business opportunities, and increase compliance challenges.

As these conditions or similar ones continue to exist or worsen, the Company could experience continuing or increased adverse effects on its financial condition.

***The Company and its subsidiary business are subject to interest rate risk and variations in interest rates may negatively affect its financial performance.***

The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are highly



## **Table of Contents**

sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, and (ii) the fair value of the Company's financial assets and liabilities. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

***The Bank's ability to pay dividends is subject to regulatory limitations which, to the extent the Company requires such dividends in the future, may affect the Company's ability to pay its obligations and pay dividends.***

The Company is a separate legal entity from the Bank and its subsidiaries and does not have significant operations of its own. The Company currently depends on the Bank's cash and liquidity as well as dividends to pay the Company's operating expenses and dividends to shareholders. No assurance can be made that in the future the Bank will have the capacity to pay the necessary dividends and that the Company will not require dividends from the Bank to satisfy the Company's obligations. The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Bank and other factors, that the OCC, the Bank's primary regulator, could assert that payment of dividends or other payments by the Bank are an unsafe or unsound practice. In the event the Bank is unable to pay dividends sufficient to satisfy the Company's obligations or is otherwise unable to pay dividends to the Company, the Company may not be able to service its obligations as they become due, including payments required to be made to the FCBI Capital Trust, a business trust subsidiary of the Company, or pay dividends on the Company's common stock. Consequently, the inability to receive dividends from the Bank could adversely affect the Company's financial condition, results of operations, cash flows and prospects.

***The Company is subject to restrictions on its ability to declare or pay dividends and repurchase its shares as a result of its participation in the Treasury's TARP Capital Purchase Program.***

On November 21, 2008, the Company issued to the Treasury for aggregate consideration of \$41.50 million (i) 41,500 shares of Series A Preferred Stock and (ii) a Warrant to purchase 176,546 shares of the Company's Common Stock pursuant to the terms of the Purchase Agreement. Under the terms of the Purchase Agreement, the Company's ability to declare or pay dividends on any of its shares is restricted. Specifically, the Company may not declare dividend payments on common, junior preferred or *pari passu* preferred shares if it is in arrears on the dividends on the Series A Preferred Stock. Further, the Company may not increase the dividends on its Common Stock above the amount of the last quarter cash dividend per share declared prior to October 13, 2009, which was \$0.28 per share, without the Treasury's approval until the third anniversary of the investment unless all of the Series A Preferred Stock has been redeemed or transferred.

The Company's ability to repurchase its shares is also restricted under the terms of the Purchase Agreement. The Treasury's consent generally is required for the Company to make any stock repurchases until the third anniversary of the investment by the Treasury unless all of the Series A Preferred Stock has been redeemed or transferred. Further, common, junior preferred or *pari passu* preferred shares may not be repurchased if the Company is in arrears on the Series A Preferred Stock dividends.

***The Bank's allowance for loan losses may not be adequate to cover actual losses.***

Like all financial institutions, the Bank maintains an allowance for loan losses to provide for probable losses. The Bank's allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses

could materially and adversely affect the Bank's operating results. The Bank's allowance for loan losses is determined by analyzing historical loan losses, current trends in delinquencies and charge-offs, plans for problem loan resolution, changes in the size and composition of the loan portfolio, and industry information. Also included in management's estimates for loan losses are considerations with respect to the impact of economic events, the

## **Table of Contents**

outcome of which are uncertain. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, that may be beyond the Bank's control, and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review the Bank's loans and allowance for loan losses. Although we believe that the Bank's allowance for loan losses is adequate to provide for probable losses, we cannot assure you that we will not need to increase the Bank's allowance for loan losses or that regulators will not require us to increase this allowance. Either of these occurrences could materially and adversely affect the Company's earnings and profitability.

***The Company's business is subject to various lending and other economic risks that could adversely impact the Company's results of operations and financial condition.***

Changes in economic conditions, particularly an economic slowdown, could hurt the Company's business. The Company's business is directly affected by political and market conditions, broad trends in industry and finance, legislative and regulatory changes, and changes in governmental monetary and fiscal policies and inflation, all of which are beyond the Company's control. A deterioration in economic conditions, in particular an economic slowdown within the Company's geographic region, could result in the following consequences, any of which could have a material adverse effect on the Company's business:

loan delinquencies may increase;

problem assets and foreclosures may increase;

demand for the Company's products and services may decline; and

collateral for loans made by the Company may decline in value, in turn reducing a client's borrowing power, and reducing the value of assets and collateral associated with the Company's loans held for investment.

***The declining real estate market could impact the Company's business.***

The Company's business activities and credit exposure are concentrated in Virginia, West Virginia, North Carolina, Tennessee and the surrounding region. A continued downturn in this regional real estate market could hurt the Company's business because of the geographic concentration within this regional area. If there is a significant decline in real estate values, the collateral for the Company's loans will provide less security. As a result, the Company's ability to recover on defaulted loans by selling the underlying real estate would be diminished, and we would be more likely to suffer losses on defaulted loans.

***The Company's level of credit risk is increasing due to its focus on commercial lending, and the concentration on small businesses and middle market customers with heightened vulnerability to economic conditions.***

Commercial business and commercial real estate loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial business and commercial real estate loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Bank's commercial business loans are made to small business or middle market customers who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made or acquired by the Company in recent years and the borrowers may not have experienced a complete business or economic cycle.

***The Bank may suffer losses in its loan portfolio despite its underwriting practices.***

The Bank seeks to mitigate the risks inherent in the Bank's loan portfolio by adhering to specific underwriting practices. These practices include analysis of a borrower's prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although the Bank believes that its underwriting criteria are appropriate for the various kinds of loans it makes, the Bank may incur losses on loans that meet its underwriting criteria, and these losses may exceed the amounts set aside as reserves in the Bank's allowance for loan losses.

**Table of Contents**

***The Company and its subsidiaries are subject to extensive regulation which could adversely affect them.***

The Company and its subsidiaries' operations are subject to extensive regulation and supervision by federal and state governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of the Company's operations. Banking regulations governing the Company's operations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not security holders. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. These laws, rules and regulations, or any other laws, rules or regulations, that may be adopted in the future, could make compliance more difficult or expensive, restrict the Company's ability to originate, broker or sell loans, further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by the Bank and otherwise adversely affect the Company's business, financial condition or prospects.

On October 3, 2008, the EESA was signed into law. Pursuant to the EESA, the Treasury was granted the authority to take a range of actions for the purpose of stabilizing and providing liquidity to the U.S. financial markets and has proposed several programs, including the purchase by the Treasury of certain troubled assets from financial institutions and the direct purchase by the Treasury of equity of financial institutions. There can be no assurance, however, as to the actual impact that the foregoing or any other governmental program will have on the financial markets. The failure of the financial markets to stabilize and a continuation or worsening of current financial market conditions could materially and adversely affect the Company's business, financial condition, results of operations, access to credit or the trading price of its Common Stock. In addition, current initiatives of President Obama's Administration and the possible enactment of recently proposed bankruptcy legislation may adversely affect the Company's financial condition and results of operations.

The financial services industry is likely to face increased regulation and supervision as a result of the existing financial crisis, and there may be additional requirements and conditions imposed on the Company as a result of its participation in the TARP Capital Purchase Program. Such additional regulation and supervision may increase the Company's costs and limit its ability to pursue business opportunities. The affects of such recently enacted, and proposed, legislation and regulatory programs on the Company cannot reliably be determined at this time.

***The Company faces strong competition from other financial institutions, financial service companies and other organizations offering services similar to those offered by the Company and its subsidiaries, which could hurt the Company's business.***

The Company's business operations are centered primarily in Virginia, West Virginia, North Carolina, Tennessee and the surrounding region. Increased competition within this region may result in reduced loan originations and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer the types of loans and banking services that we offer. These competitors include other savings associations, national banks, regional banks and other community banks. The Company also faces competition from many other types of financial institutions, including finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In particular, the Bank's competitors include other state and national banks and major financial companies whose greater resources may afford them a marketplace advantage by

enabling them to maintain numerous banking locations and mount extensive promotional and advertising campaigns.

Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of

**Table of Contents**

larger clients. These institutions, particularly to the extent they are more diversified than the Company, may be able to offer the same loan products and services that the Company offers at more competitive rates and prices. If the Company is unable to attract and retain banking clients, the Company may be unable to continue the Bank's loan and deposit growth and the Company's business, financial condition and prospects may be negatively affected.

***Potential Acquisitions May Disrupt the Company's Business and Dilute Stockholder Value***

The Company may seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

Potential exposure to unknown or contingent liabilities of the target company.

Exposure to potential asset quality issues of the target company.

Difficulty and expense of integrating the operations and personnel of the target company.

Potential disruption to the Company's business.

Potential diversion of the Company's management's time and attention.

The possible loss of key employees and customers of the target company.

Difficulty in estimating the value of the target company.

Potential changes in banking or tax laws or regulations that may affect the target company.

The Company regularly evaluates merger and acquisition opportunities and conducts due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of the Company's tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on the Company's financial condition and results of operations.

In the fourth quarter of 2008, the Company completed its acquisition of Coddle Creek Financial Corp., the holding company for Mooresville Savings Bank, Inc., SSB, located in Mooresville, North Carolina. In addition, the Company's wholly owned insurance subsidiary, GreenPoint, acquired Carr & Hyde Insurance, based in Warrenton, Virginia, among other agencies. Details of these transactions are presented in Note 2 in the Notes to the Consolidated Financial Statements included in Item 8 hereof.

***The Company may lose members of our management team due to compensation restrictions***

The Company's ability to retain key officers and employees may be negatively impacted by recent legislation and regulation affecting the financial services industry. On February 17, 2009, the ARRA was signed into law. While the Treasury must promulgate regulations to implement the restrictions and standards set forth in the new law, the ARRA, among other things, significantly expands the executive compensation restrictions previously imposed by the EESA.

Such restrictions apply to any entity that has received or will receive financial assistance under the TARP, and will generally continue to apply for as long as any obligation arising from financial assistance provided under TARP, including preferred stock issued under the Capital Purchase Program, remains outstanding. As a result of the Company's participation in the TARP Capital Purchase Program, the restrictions and standards set forth in the ARRA are applicable to the Company. Such restrictions and standards may impact management's ability to retain key officers and employees as well as the Company's ability to compete with financial institutions that are not subject to the same limitations as the Company under the ARRA.



**Table of Contents****ITEM 1B. UNRESOLVED STAFF COMMENTS.**

The Company has no unresolved staff comments as of the filing date of this 2008 Annual Report on Form 10-K.

**ITEM 2. PROPERTIES.**

The Company generally owns its offices, related facilities, and unimproved real property. The principal offices of the Company are located at One Community Place, Bluefield, Virginia, where the Company owns and occupies approximately 36,000 square feet of office space. As of December 31, 2008, the Company operated in 61 locations throughout the five states of Virginia, West Virginia, North and South Carolina, and Tennessee. The Company owns 47 of its banking offices while others are leased or are located on leased land. The Company also operates ten insurance offices throughout North Carolina and Virginia, including its headquarters in High Point, North Carolina. The Company owns one of its insurance offices and leases the remaining locations. There are no mortgages or liens against any property of the Company. A complete listing of all branches and ATM sites can be found on the Internet at [www.fcbresource.com](http://www.fcbresource.com). Information on such website is not part of this Annual Report on Form 10-K.

**ITEM 3. LEGAL PROCEEDINGS.**

The Company is currently a defendant in various legal actions and asserted claims involving lending and collection activities and other matters 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 or the results of operations of the Company.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

No matters were submitted to a vote of security holders during the fourth quarter of 2008.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

The number of common stockholders of record on December 31, 2008, was 2,461 and outstanding shares totaled 11,567,449. The number of common stockholders is measured by the number of recordholders. The Company's common stock trades on the NASDAQ Global Select market under the symbol **FCBC**.

Cash dividends for 2008 totaled \$1.12 per share and \$1.08 per share 2007. Total dividends paid for the current and prior years totaled \$12.45 million and \$12.08 million, respectively.

The following table sets forth the high and low stock prices, book value per share, and dividends paid per share on the Company's common stock during the periods indicated.

	2008		2007	
	High	Low	High	Low
<b>Sales Price Per Share</b>				
First quarter	\$ 34.89	\$ 28.00	\$ 42.30	\$ 35.19
Second quarter	34.89	27.79	39.21	28.89

Third quarter	39.00	25.54	37.45	25.40
Fourth quarter	38.00	23.49	38.85	30.07

**Table of Contents**

	<b>2008</b>	<b>2007</b>
<b>Cash Dividends Per Share</b>		
First quarter	\$ 0.28	\$ 0.27
Second quarter	0.28	0.27
Third quarter	0.28	0.27
Fourth quarter	0.28	0.27
Total	\$ 1.12	\$ 1.08

As a condition to the Company's participation in the Treasury's Capital Purchase Program, the Company's ability to declare or pay dividends on any of its shares is restricted. Specifically, the Company may not declare dividend payments on common, junior preferred, or *pari passu* preferred shares if it is in arrears on the dividends on the Series A Preferred Stock. Further, the Company may not increase the dividends on its Common Stock above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008, which was \$0.28 per share, without the Treasury's approval until the third anniversary of the investment unless all of the Series A Preferred Stock has been redeemed or transferred.

The Company's stock repurchase plan, as amended, allows the purchase and retention of up to 1,100,000 shares. The plan has no expiration date, remains open and no plans have expired during the reporting period. No determination has been made to terminate the plan or to stop making purchases. The Company made no open market purchases of its equity securities during the fourth quarter of 2008. The maximum number of shares that may yet be purchased under the plan was 616,215 at December 31, 2008.

As a condition to the Company's participation in the Treasury's Capital Purchase Program, the Company is restricted from repurchasing shares of its Common Stock until the earlier of the third anniversary of the date of the issuance of the Series A Preferred Stock and the date on which the Series A Preferred Stock has been redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock. As such, the Company does not anticipate purchasing any shares of its Common Stock under its repurchase plan during 2009.

**Table of Contents****Total Return Analysis**

The following chart was compiled by SNL Securities LC, and compares cumulative total shareholder return of the Company's Common Stock for the five-year period ended December 31, 2008, with the cumulative total return of the S&P 500 Index, the NASDAQ Composite index, and the Asset Size & Regional Peer Group. The Asset Size & Regional Peer Group consists of 53 bank holding companies that are traded on the NASDAQ, OTC Bulletin Board, and pink sheets with total assets between \$1 billion and \$5 billion and are located in the Southeast Region of the United States. The cumulative returns include payment of dividends by the Company.

**Total Return Performance**

<b>Index</b>	<b>Period Ending</b>					
	<b>12/31/03</b>	<b>12/31/04</b>	<b>12/31/05</b>	<b>12/31/06</b>	<b>12/31/07</b>	<b>12/31/08</b>
First Community Bancshares, Inc.	100.00	112.26	100.23	131.31	109.39	123.88
S&P 500	100.00	110.88	116.33	134.70	142.10	89.53
NASDAQ Composite	100.00	108.59	110.08	120.56	132.39	78.72
Asset Size & Regional Peer Group	100.00	115.03	119.74	134.09	94.70	81.49

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA.**

Five-Year Selected Financial Data	At or for the Year Ended December 31,				
	2008	2007	2006	2005	2004
	(Amounts in thousands, except per share data)				
<b>Balance Sheet Summary</b>					
<b>(at end of period)</b>					
Securities(a)	\$ 529,393	\$ 676,195	\$ 528,389	\$ 428,554	\$ 410,218
Loans held for sale	1,024	811	781	1,274	1,194
Loans, net of unearned income	1,298,159	1,225,502	1,284,863	1,331,039	1,238,756
Allowance for loan losses	15,978	12,833	14,549	14,736	16,339
Total assets	2,133,314	2,149,838	2,033,698	1,952,483	1,830,822
Deposits	1,503,758	1,393,443	1,394,771	1,403,220	1,356,719
Borrowings	381,791	517,843	406,556	335,885	274,212
Total liabilities	1,912,972	1,932,740	1,820,968	1,757,982	1,647,589
Stockholders' equity	220,342	217,098	212,730	194,501	183,233
<b>Summary of Earnings</b>					
Total interest income	\$ 110,765	\$ 127,591	\$ 120,026	\$ 109,508	\$ 96,136
Total interest expense	44,930	59,276	48,381	35,880	26,953
Provision for loan losses	7,422	717	2,706	3,706	2,671
Non-interest income	32,297	24,831	21,323	22,305	17,329
Investment securities impairment	29,923				
Non-interest expense	60,516	50,463	49,837	55,591	48,035
Income from continuing operations before income taxes	271	17,135	19,102	14,331	18,477
Income tax (benefit) expense	(2,810)	12,334	11,477	10,191	9,786
Income from continuing operations	3,081	29,632	28,948	26,445	26,020
Loss from discontinued operations before income taxes				(233)	(5,746)
Income tax benefit				(91)	(2,090)
Loss from discontinued operations				(142)	(3,656)
Net income	3,081	29,632	28,948	26,303	22,364
Dividends on preferred stock	255				
Net income available to common shareholders	2,826	29,632	28,948	26,303	22,364

(a) Reflects the reclassification during 2004 of Federal Reserve Bank and Federal Home Loan Bank stock from Securities Available for Sale to Other Assets, consistent with the 2005-2008 presentation.

**Table of Contents**

<b>Five-Year Selected Financial Data-continued</b>	<b>At or for the Year Ended December 31,</b>				
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Per Share Data</b>					
Basic earnings per share	\$ 0.26	\$ 2.64	\$ 2.58	\$ 2.33	\$ 1.99
Basic earnings per common share-continuing operations	0.26	2.64	2.58	2.35	2.32
Basic loss per common share-discontinued operations				(0.02)	(0.33)
Diluted earnings per common share	\$ 0.25	\$ 2.62	\$ 2.57	\$ 2.32	\$ 1.97
Diluted earnings per common share-continuing operations	0.25	2.62	2.57	2.33	2.29
Diluted loss per common share-discontinued operations				(0.01)	(0.32)
Cash dividends	\$ 1.12	\$ 1.08	\$ 1.04	\$ 1.02	\$ 1.00
Book value per common share at year-end	\$ 15.46	\$ 19.61	\$ 18.92	\$ 17.29	\$ 16.29
<b>Selected Ratios</b>					
Return on average assets	0.14%	1.39%	1.46%	1.37%	1.24%
Return on average assets-continuing	0.14%	1.39%	1.46%	1.38%	1.45%
Return on average equity	1.40%	13.54%	14.32%	13.79%	12.53%
Return on average equity-continuing	1.40%	13.54%	14.32%	13.87%	14.58%
Average equity to average assets	9.86%	10.30%	10.21%	9.91%	9.88%
Average equity to average assets-continuing	9.86%	10.30%	10.21%	9.91%	9.96%
Dividend payout	430.77%	40.91%	40.31%	43.78%	50.25%
Risk based capital to risk adjusted assets	12.91%	12.34%	12.69%	11.65%	12.09%
Leverage ratio	9.75%	8.09%	8.50%	7.77%	7.62%

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.****Executive Overview**

First Community Bancshares, Inc. is a bank holding company that, through its bank subsidiary, provides commercial banking services and has positioned itself as a regional community bank and a financial services alternative to larger banks which often provide less emphasis on personal relationships, and smaller community banks which lack the capital and resources to efficiently serve customer needs. The Company has focused its growth efforts on building financial partnerships and more enduring and complete relationships with businesses and individuals through a very personal and local approach to banking and financial services. The Company and its operations are guided by a strategic plan which includes growth through acquisitions and through office expansion in new market areas including strategically identified metro markets in Virginia, West Virginia, North Carolina, South Carolina, and Tennessee. While the Company's mission remains that of a community bank, management believes that entry into new markets will accelerate the Company's growth rate by diversifying the demographics of its customer base and customer prospects and by generally increasing its sales and service network.

**Economy**

The local economies in which the Company operates are diverse and span a five-state region. West Virginia and Southwest Virginia continue to benefit from expanding coal and natural gas operations. These economies have

significant exposure to extractive industries, such as coal and natural gas, which become more active and lucrative when oil prices rise. The local economies in the central portion of North Carolina have suffered in recent years due to foreign competition in both furniture and textiles, as well as consolidation in the financial services industry. Despite these detractions, the economies in this region continue to benefit from national companies relocating and expanding in the Triad and Central Piedmont areas. The Eastern Virginia local economies have, in recent years, benefited from a wide array of corporate and government activities and relocations.

## **Table of Contents**

The economies in each of the regions within the Company's markets have experienced significant declines in residential development and construction, consistent with national trends. These declines have led to contraction in residential land development and construction, which have historically been important components of the Company's lending activities. The economies of our legacy markets have remained relatively stable and unemployment levels are among the lowest in the nation as of December 31, 2008.

The capital markets have experienced significant illiquidity throughout 2008 and continuing through the date of this report. This has had an adverse effect on the valuation of debt securities, including portions of the Company's investment securities portfolio.

### ***Competitive Focus***

As the Company competes for increased market share and growth in both loans and deposits it continues to encounter strong competition from many sources. Bank expansion through de novo branches and loan production offices has grown in popularity as a means of reaching out to new markets. Many of the markets targeted by the Company are also being entered by other banks in nearby markets and, in some cases, from more distant markets. The expansion of banks and credit unions over recent years, coupled with liquidity pressures brought on in 2008 from the credit market turmoil and recessionary economy, has intensified competitive pressures on core deposit generation and retention. These pressures on core deposits have continued to put pressure on net interest margin. Despite strong competition from other banks, credit unions and mortgage companies, the Company has seen success in newly established offices in Winston-Salem, North Carolina, as well as other markets in both Virginia and North Carolina. The Company attributes this measure of success to its recruitment of local, established bankers and loan personnel in those targeted markets. Competitive forces impact the Company through pressure on interest yields, product fees and loan structure and terms; however, the Company has countered these pressures with its relationship style of banking, competitive pricing and a disciplined approach to loan underwriting.

### **Application of Critical Accounting Policies**

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

Estimates, assumptions, and judgments are necessary principally when assets and liabilities are required to be recorded at estimated fair value, when a decline in the value of an asset carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded based upon the probability of occurrence of a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by third party sources, when available. When third party information is not available, valuation adjustments are estimated by management primarily through the use of financial 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 following is a summary of the Company's more subjective and complex critical accounting policies. In addition, 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 investment security valuation, 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.

## **Table of Contents**

### ***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, as amended, 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.

### ***Allowance for Loan Losses***

The allowance for loan losses is maintained at levels management deems adequate to absorb probable losses inherent in the portfolio, and is based on management's evaluation of the risks in the loan portfolio and changes in the nature and volume of loan activity. The Company consistently applies a review process to periodically evaluate loans for changes in credit risk. This process serves as the primary means by which the Company evaluates the adequacy of the allowance for loan losses.

The Company determines the allowance for loan losses by making specific allocations to impaired loans that exhibit inherent weaknesses and various credit risk factors, and general allocations to commercial, residential real estate, and consumer loans are developed giving weight to risk ratings, historical loss trends and management's judgment concerning those trends and other relevant factors. These factors may include, among others, actual versus estimated losses, regional and national economic conditions, business segment and portfolio concentrations, industry competition and consolidation, and the impact of government regulations. The foregoing analysis is performed by management to evaluate the portfolio and calculate an estimated valuation allowance through a quantitative and qualitative analysis that applies risk factors to those identified risk areas.

This risk management evaluation is applied at both the portfolio level and the individual loan level for commercial loans and credit relationships while the level of consumer and residential mortgage loan allowance is determined primarily on a total portfolio level based on a review of historical loss percentages and other qualitative factors including concentrations, industry specific factors and economic conditions. The commercial portfolio requires more specific analysis of individually significant loans and the borrower's underlying cash flow, business conditions, capacity for debt repayment and the valuation of secondary sources of payment, such as collateral. This analysis may result in specifically identified weaknesses and corresponding specific impairment allowances. While allocations are made to specific loans and classifications within the various categories of loans, the allowance for loan losses is available for all loan losses.

The use of various estimates and judgments in the Company's ongoing evaluation of the required level of allowance can significantly impact the Company's results of operations and financial condition and may result in either greater provisions against earnings to increase the allowance or reduced provisions based upon management's current view of portfolio and economic conditions and the application of revised estimates and assumptions.

## **Table of Contents**

Differences between actual loan loss experience and estimates are reflected through adjustments either increasing or decreasing the loan loss provision based upon current measurement criteria.

### ***Acquisitions and Intangible Assets***

The Company may, from time to time, engage in business combinations with other companies. The acquisition of a business is generally accounted for under purchase accounting rules promulgated by the Financial Accounting Standards Board ( FASB ). Purchase accounting requires the recording of underlying assets and liabilities of the entity acquired at their fair market value. Any excess of the purchase price of the business over the net assets acquired and any identified intangibles is recorded as goodwill. Fair values are assigned based on quoted prices for similar assets, if readily available, or appraisal by qualified independent parties for relevant asset and liability categories. Financial assets and liabilities are typically valued using discount models which apply current discount rates to streams of cash flow. All of these valuation methods require the use of assumptions which can result in alternate valuations and varying levels of goodwill and, in some cases, amortization expense or accretion income.

Management must also make estimates of useful or economic lives of certain acquired assets and liabilities. These lives are used in establishing amortization and accretion of some intangible assets and liabilities, such as the intangible associated with core deposits acquired in the acquisition of a commercial bank.

Goodwill is recorded as the excess of the purchase price, if any, over the fair value of the revalued net assets. Goodwill is tested annually in the month of November for possible impairment by comparing the fair value of the unit with its book value, including goodwill. If the fair value of the Company is greater than its book value, no goodwill impairment exists. However, if the book value of the Company is greater than its determined fair value, goodwill impairment may exist and further testing is required to determine the amount, if any, of the actual impairment loss. Further testing would use a discounted cash flow model applied to the anticipated stream of cash flows from operations of the business or segment being tested. Impairment testing necessarily uses estimates in the form of growth and attrition rates, anticipated rates of return, and discount rates. These estimates have a direct bearing on the results of the impairment testing and serve as the basis for management's conclusions as to impairment.

### ***Income Taxes***

The establishment of provisions for federal and state income taxes is a complex area of accounting which also involves the use of judgments and estimates in applying relevant tax statutes. The Company operates in multiple state tax jurisdictions and this requires the appropriate allocation of income and expense to each state based on a variety of apportionment or allocation bases. Management strives to keep abreast of changes in tax law and the issuance of regulations which may impact tax reporting and provisions for income tax expense. The Company is also subject to audit by federal and state tax authorities. Results of these audits may produce indicated liabilities which differ from Company estimates and provisions. The Company continually evaluates its exposure to possible tax assessments arising from audits and records its estimate of possible exposure based on current facts and circumstances.

### **Recent Acquisitions and Branching Activity**

In November 2008, the Company acquired Coddle Creek Financial Corp. (Coddle Creek), headquartered in Mooresville, North Carolina. Coddle Creek had three full service branch offices located in Mooresville, Cornelius, and Huntersville, North Carolina. At acquisition, Coddle Creek had total assets of \$158.66 million, total loans of \$136.99 million and total deposits of \$137.06 million. Under the terms of the merger agreement, shares of Coddle Creek common stock were exchanged for .9046 shares of the Company's common stock and \$19.60 in cash. The total deal value, including the cash-out of outstanding stock options, was approximately \$32.29 million. Concurrent with the Coddle Creek acquisition, Mooresville Savings Bank, Inc., SSB, the wholly-owned subsidiary of Coddle Creek,

was merged into the Bank. As a result of the acquisition and preliminary purchase price allocation, approximately \$14.41 million in goodwill was recorded which represents the excess of the purchase price over the fair market value of the net assets acquired and identified intangibles.

## **Table of Contents**

In September 2007, the Company acquired GreenPoint Insurance Group ( GreenPoint ), an insurance agency located in High Point, North Carolina. As of September 30, 2007, GreenPoint had annualized commission revenues of approximately \$4.60 million. 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 acquisition of GreenPoint added \$7.19 million of goodwill and intangibles to the Company's balance sheet. The Company also assumed \$5.57 million in debt in connection with the acquisition, of which approximately \$5.00 million was retired at closing.

Throughout 2008, GreenPoint acquired a total of five insurance agencies. The two largest acquisitions were Carr & Hyde in Warrenton, Virginia, and REL in Greensboro, North Carolina. GreenPoint issued aggregate cash consideration of approximately \$2.04 million through 2008 in connection with these acquisitions. Acquisition terms in all instances call for issuing further cash consideration if certain operating performance targets are met. If those targets are met, the value of the consideration ultimately paid will be added to the cost of the acquisitions. GreenPoint's 2008 acquisitions added approximately \$2.04 million of goodwill and intangibles to the Company's balance sheet.

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

In November 2006, the Company completed the acquisition of Investment Planning Consultants, Inc. ( IPC ), a registered investment advisory firm located in Bluefield, West Virginia. In connection with the initial payment of approximately \$1.47 million, the Company issued 39,874 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of IPC are entitled to additional consideration of \$1.43 million in the form of the Company's common stock if certain future operating performance targets are met. If those operating targets are met, portions of the value of the consideration ultimately paid will be added to the cost of the acquisition, which will increase the amount of goodwill related to the acquisition. In December 2008 and 2007, the Company issued 8,361 and 13,401 shares of its common stock, respectively, in connection with the acquisition of IPC.

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

The Company opened seven branches during 2007 and one during 2008. New branches included two offices in Winston-Salem, North Carolina, two offices in Richmond, Virginia, and new offices in Daniels, Princeton, and Summersville, West Virginia.

## **RESULTS OF OPERATIONS**

### ***2008 COMPARED TO 2007***

Net income for 2008 was \$2.83 million, a decrease of \$26.81 million from \$29.63 million in 2007. Basic and diluted earnings per share for 2008 were \$0.26 and \$0.25, respectively, compared with basic and diluted earnings per share of \$2.64 and \$2.62, respectively, in 2007. The significant decline in earnings in 2008 reflect a fourth quarter non-cash pre-tax impairment charge of \$29.92 million on certain investment securities. The Company's key profitability ratios are return on average assets and return on average equity. Returns on average assets for 2008 and 2007 were 0.14% and 1.40%, respectively.

The Company acquired Coddle Creek, a \$158.66 million bank holding company, in November 2008. Accordingly, the operations of Coddle Creek were not significant to the 2008 results of operations.

## **Table of Contents**

### *Net Interest Income*

The primary source of the Company's earnings is net interest income, the difference between income on earning assets and the cost of funds supporting those assets. Significant categories of earning assets are loans and securities while deposits and borrowings represent the major portion of interest-bearing liabilities. For purposes of the following discussion, comparison of net interest income is performed on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those assets which are fully taxable (see the table titled Average Balance Sheets and Net Interest Income Analysis).

Net interest income was \$65.84 million for 2008, compared with \$68.32 million for 2007. Tax-equivalent net interest income totaled \$69.97 million for 2008, a decrease of \$2.82 million from the \$72.79 million reported for 2007. The decrease is attributable to a \$4.61 million decrease due to volume and a \$1.79 million increase due to rate changes on the underlying assets and liabilities.

During 2008, average earning assets decreased \$114.59 million while average interest-bearing liabilities decreased \$45.79 million, in each case over the comparable period. The yield on average earning assets decreased 51 basis points to 6.38% for 2008 from 6.89% for 2007. Short-term market interest rates decreased precipitously throughout 2008, culminating in a move by the Federal Reserve to create a range of zero to 25 basis points as its target for federal funds. During 2008, the target federal funds rate decreased 400 basis points, and the average bank prime loan rate decreased in concert. Those decreases were the largest driver in the overall decrease in the Company's yield on average earning assets.

Total cost of average interest-bearing liabilities decreased 78 basis points to 2.79% during 2008. The Company's time deposit portfolio experienced significant downward repricing during 2008, as many of the higher-rate certificates were not renewed. The net result was an increase of 27 basis points to net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities. Spread for 2008 was 3.59% compared with 3.32% for 2007. The Company's tax-equivalent net interest margin of 3.88% for 2008 represents an increase of eight basis points from 3.80% in 2007.

Loan interest income decreased \$13.26 million during 2008 as compared with 2007 as volume declined, while the yield on loans decreased 78 basis points. During 2008, the tax-equivalent yield on available-for-sale securities increased three basis points to 5.80% while the average balance decreased by \$48.55 million as compared with 2007.

Average interest-bearing balances with banks declined \$9.17 million during 2008 to \$15.49 million, while the yield decreased 278 basis points to 1.98%. These balances consist primarily of overnight liquidity, and the yield on these balances is largely affected by changes in the target federal funds rate.

The average total cost of interest-bearing deposits decreased 72 basis points in 2008 compared with 2007. The average rate paid on interest-bearing demand deposits decreased 14 basis points, while the average rate paid on savings, which includes money market and savings accounts, decreased 71 basis points. The Company was successful in keeping rates paid on interest-bearing checking accounts relatively stable and increased money market account rates to remain competitive and retain deposit funding. In 2008, average time deposits decreased \$26.27 million while the average rate paid decreased 75 basis points to 3.69% as compared with 2007. The level of average non interest-bearing demand deposits decreased \$16.79 million to \$211.79 million in 2008 compared with the prior year.

Average federal funds purchased increased \$10.17 million in 2008, while the average rate paid on those funds also decreased, as they are closely tied to the target federal funds rate. Average retail repurchase agreements decreased \$24.20 million in 2008, while the average rate paid on those funds decreased, as they are closely tied to the target federal funds rate and 3-month LIBOR. Average Federal Home Loan Bank ( FHLB ) advances and other borrowings



decreased \$13.84 million while the rate paid on those borrowings decreased 59 basis points in 2008. The Company reduced end-of-period FHLB advances by \$75.00 million during 2008. Other borrowings include the Company's trust preferred issuance of \$15.46 million, which is indexed to 3-month LIBOR.

**Table of Contents****Average Balance Sheets and Net Interest Income Analysis**

	2008			2007			2006	
	Average Balance	Interest(1)	Yield/ Rate(1)	Average Balance (Dollars in thousands)	Interest(1)	Yield/ Rate(1)	Average Balance	Interest(1)
<b>Assets:</b>								
Available for sale securities	1,199,076	80,305	6.70%	1,251,028	93,561	7.48%	1,316,475	97,500
Available-for-sale securities	576,864	33,438	5.80%	625,413	36,113	5.77%	428,579	23,584
Available-for-sale securities	10,302	849	8.24%	15,220	1,212	7.96%	21,298	1,708
Interest-bearing deposits	15,489	306	1.98%	24,662	1,175	4.76%	27,289	1,244
Other assets	1,801,731	114,898	6.38%	1,916,323	132,061	6.89%	1,793,641	124,036
Other assets	244,455			208,916			186,639	
	\$ 2,046,186			\$ 2,125,239			\$ 1,980,280	
<b>Interest-bearing liabilities:</b>								
Deposits	\$ 174,809	\$ 292	0.17%	\$ 147,856	\$ 456	0.31%	\$ 146,248	\$ 462
Deposits	312,363	4,693	1.50%	330,969	7,327	2.21%	343,854	6,857
Deposits	671,729	24,807	3.69%	697,996	30,974	4.44%	680,380	26,549
Other interest-bearing	1,158,901	29,792	2.57%	1,176,821	38,757	3.29%	1,170,482	33,868
Other interest-bearing	15,942	362	2.27%	5,773	312	5.40%	3,367	198
Other interest-bearing	143,159	3,029	2.12%	167,359	5,809	3.47%	140,623	4,578
Other interest-bearing	50,000	1,630	3.26%	50,000	2,181	4.36%	6,849	303
Other interest-bearing	244,801	10,117	4.13%	258,644	12,217	4.72%	200,570	9,434
Other interest-bearing	453,902	15,138	3.34%	481,776	20,519	4.26%	351,409	14,513
Other interest-bearing	1,612,803	44,930	2.79%	1,658,597	59,276	3.57%	1,521,891	48,381
Other interest-bearing	211,791			228,583			237,714	
Other interest-bearing	19,850			19,210			18,551	
Other interest-bearing	201,742			218,849			202,124	
	\$ 2,046,186			\$ 2,125,239			\$ 1,980,280	
Net interest income		\$ 69,968			\$ 72,785			\$ 75,655

Interest rate spread(3)	3.59%	3.32%
Interest margin(4)	3.88%	3.80%

- (1) Fully taxable equivalent at the rate of 35%.
- (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 tax equivalent yield on earning assets and cost of funds.
- (4) Represents tax equivalent net interest income divided by average interest-earning assets.

**Table of Contents***Rate and Volume Analysis of Interest*

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

	2008 Compared to 2007			2007 Compared to 2006		
	\$ Increase/(Decrease) due to			\$ Increase/(Decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Amounts in thousands)					
Interest Earned On(1):						
Loans	\$ (3,770)	\$ (9,486)	\$ (13,256)	\$ (4,906)	\$ 967	\$ (3,939)
Securities available for sale	(2,815)	140	(2,675)	11,314	1,215	12,529
Securities held to maturity	(407)	44	(363)	(484)	(12)	(496)
Interest-bearing deposits with other banks	(338)	(531)	(869)	(130)	61	(69)
Total interest-earning assets	(7,330)	(9,833)	(17,163)	5,794	2,231	8,025
Interest Paid On:						
Demand deposits	108	(272)	(164)	5	(11)	(6)
Savings deposits	(392)	(2,242)	(2,634)	(242)	712	470
Time deposits	(1,130)	(5,037)	(6,167)	702	3,723	4,425
Federal funds purchased	75	(25)	50	129	(15)	114
Retail repurchase agreements	(751)	(2,029)	(2,780)	913	318	1,231
Wholesale repurchase agreements		(551)	(551)	1,882	(4)	1,878
FHLB borrowings and other long-term debt	(629)	(1,471)	(2,100)	2,743	40	2,783
Total interest-bearing liabilities	(2,719)	(11,627)	(14,346)	6,132	4,763	10,895
Change in tax-equivalent net interest income	\$ (4,611)	\$ 1,794	\$ (2,817)	\$ (338)	\$ (2,532)	\$ (2,870)

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

*Provision for Loan Losses*

The provision for loan losses for 2008 was \$7.42 million, an increase of \$6.71 million when compared with 2007. The increase in loan loss provision between the periods is primarily attributable to rising loss factors as net charge-offs escalated during 2008. Qualitative risk factors were also higher, reflective of the higher risk of inherent loan losses due to rising unemployment, recessionary pressures, and devaluations of various categories of collateral, including real estate and marketable securities. Net charge-offs for 2008 and 2007 were \$5.45 million and \$2.43 million, respectively. Expressed as a percentage of average loans, net charge-offs increased to 0.45% for 2008 from 0.19% in

2007.

*Noninterest Income*

Noninterest income consists of all revenues which are not included in interest and fee income related to earning assets. Noninterest income for 2008, exclusive of the \$29.92 million other-than-temporary impairment charge, was \$32.30 million compared with \$24.83 million in 2007. Non-interest income for 2008 was bolstered by the addition of insurance revenues from 2008 acquisitions, as well as significantly higher deposit service charges, a result of new retail marketing strategies.

Wealth management income, which includes fees for trust services and commission and fee income generated by IPC, increased \$220 thousand in 2008 compared with 2007, largely a result of the increases in revenues at IPC. Service charges on deposit accounts increased \$2.68 million as a result of increased transaction fees and a larger

**Table of Contents**

number of fee-based deposit accounts. Other service charges, commissions and fees reflected an increase of \$648 thousand in 2008 compared with 2007, due mainly to increased debit card interchange income and ATM service fees.

Insurance commissions earned were \$4.99 million in 2008, compared with \$1.14 million in 2007. The Company acquired its insurance subsidiary, GreenPoint Insurance Group, Inc., in September 2007. Income for the insurance subsidiary is derived primarily from commissions earned on the sale of policies.

Other operating income for 2008 was \$3.00 million, a decrease of \$1.42 million from 2007. The largest components of that difference are a decreases in revenue from bank-owned life insurance and FHLB stock dividends of \$470 thousand and \$332 thousand, respectively, as well as a one-time gain of \$298 thousand resulting from the Company's exit from a state banking association insurance partnership in 2007.

During 2008, the Company also recognized securities gains of \$1.90 million, an increase of \$1.49 million over gains recognized in 2007.

*Noninterest Expense*

Total noninterest expense was \$60.52 million for 2008, an increase of \$10.05 million over 2007. Salaries and benefits increased approximately \$4.03 million. During 2008, total full-time equivalent employees increased to 638 from 615 at December 31, 2007. Full-time equivalent employees are calculated using the number of hours worked. Greenpoint accounted for approximately 50 full-time equivalent employees at year-end 2008 compared with 51 at year-end 2007. Total full-time equivalent employees at the Bank and IPC remained relatively stable increasing by only the 22 full-time equivalent employees in acquisition of Coddle Creek. Health insurance costs increased \$660 thousand, or 39.77%, and 401(k) employer matching costs increased \$288 thousand, or 30.54%, both due mostly to the addition of GreenPoint. The Company also deferred \$1.10 million less in loan origination costs than in 2007.

Occupancy expenses increased \$922 thousand compared with 2007, due to the full year effect of new branches, the full-year impact of GreenPoint and its acquisitions, and the partial year effect of Coddle Creek. Furniture and equipment expenses increased \$370 thousand, due mainly to a increase of \$609 thousand in depreciation and amortization expense from 2007 to 2008.

During 2008, the Company prepaid a \$25.00 million FHLB advance. The expense associated with that prepayment was \$1.65 million. The Company also repaid \$50.00 million without a prepayment penalty.

All other operating expense accounts increased \$3.09 million in 2008 compared with 2007. Contributing to the increase in operating expenses were increased advertising and new account promotions of \$550 thousand and consulting expense of \$821 thousand. Legal fees also increased \$267 thousand in 2008 compared with 2007 as the Company realized increased expenses relating to its acquisition transactions and the issuance of new preferred stock. Professional fees also increased \$241 thousand as the Company outsourced its internal audit function near mid-year 2007.

The Company uses an efficiency ratio that is a non-GAAP financial measure of operating expense control and efficiency of operations. Management believes this ratio better focuses attention on the core operating performance of the Company over time than does a GAAP-based ratio, and is highly useful in comparing period-to-period operating performance of the Company's core business operations. It is used by management as part of its assessment of its performance in managing noninterest expenses. However, this measure is supplemental and is not a substitute for an analysis of performance based on GAAP measures. The reader is cautioned that the efficiency ratio used by the Company may not be comparable to efficiency ratios reported by other financial institutions.

In general, the efficiency ratio used by the Company is noninterest expenses as a percentage of net interest income plus noninterest income. Noninterest expenses used in the calculation exclude amortization of intangibles and non-recurring expenses. Income for the ratio is increased for the favorable effect of tax-exempt income (see Average Balance Sheets and Net Interest Income Analysis), and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, non-recurring gains and losses, and other-than-temporary impairment charges. The measure is different from the GAAP-based efficiency ratio, which also is presented in this report, which is calculated using noninterest expense and income amounts as shown on the

**Table of Contents**

face of the Consolidated Statements of Income. Both types of efficiency ratio calculations are set forth and are reconciled in the table below.

Our (non-GAAP) efficiency ratios for continuing operations for 2008, 2007, and 2006 were 57.54%, 51.20%, and 51.05%, respectively. The following table details the components used in calculation of the efficiency ratios.

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Dollars in thousands)</b>		
<b>GAAP-based efficiency ratio</b>			
Noninterest expenses	\$ 60,516	\$ 50,463	\$ 49,837
Net interest income plus noninterest income	\$ 68,209	\$ 93,146	\$ 92,968
GAAP-based efficiency ratio	88.72%	54.18%	53.61%
<b>Our efficiency ratio</b>			
Noninterest expenses GAAP-based	\$ 60,516	\$ 50,463	\$ 49,837
Less non-GAAP adjustments:			
Foreclosed property expense	(382)	(185)	(248)
Amortization of intangibles	(689)	(467)	(410)
Prepayment penalties on FHLB advances	(1,647)		
Other non-core, non-recurring expense items	(51)	(100)	(581)
Adjusted non-interest expenses	57,747	49,711	48,598
Net interest income plus noninterest income GAAP-based	68,209	93,146	92,968
Plus non-GAAP adjustment:			
Tax-equivalency	4,133	4,470	4,010
Less non-GAAP adjustments:			
Security gains	(1,899)	(411)	(75)
Other-than-temporary security impairments	29,923		
Branch sale gains			(1,035)
Other non-core, non-recurring income items		(104)	(676)
Adjusted net interest income plus noninterest income	100,366	97,101	95,192
<b>Our efficiency ratio</b>	<b>57.54%</b>	<b>51.20%</b>	<b>51.05%</b>

*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 historical building rehabilitation.

Consolidated income taxes for 2008 was a benefit of \$2.81 million compared with an expense of \$12.33 million in 2007. The effective tax rate for 2008 is not meaningful due to the level of pre-tax income and the effective tax rate for



2007 was 29.39%.

***2007 COMPARED TO 2006***

Net income for 2007 was \$29.63 million, up \$684 thousand from \$28.95 million in 2006. Basic and diluted earnings per share for 2007 were \$2.64 and \$2.62, respectively, compared with basic and diluted earnings per share of \$2.58 and \$2.57, respectively, in 2006.

## **Table of Contents**

The Company's key profitability ratios are return on average assets and return on average equity. Returns on average assets for 2007 and 2006 were 1.39% and 1.46%, respectively. The returns on average equity for 2007 and 2006 were 13.54% and 14.32%, respectively.

### *Net Interest Income*

The primary source of the Company's earnings is net interest income, the difference between income on earning assets and the cost of funds supporting those assets. Significant categories of earning assets are loans and securities while deposits and borrowings represent the major portion of interest-bearing liabilities. For purposes of the following discussion, comparison of net interest income is performed on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those assets which are fully taxable (see the table titled Average Balance Sheets and Net Interest Income Analysis).

Net interest income was \$68.32 million for 2007, compared with \$71.65 million for 2006. Tax-equivalent net interest income totaled \$72.79 million for 2007, a decrease of \$2.87 million from the \$75.66 million reported for 2006. The decrease is attributable to a \$338 thousand decrease due to volume and a \$2.53 million decrease due to rate changes on the underlying assets and liabilities.

During 2007, average earning assets increased \$122.68 million while average interest-bearing liabilities increased \$136.71 million, in each case over the comparable period. The yield on average earning assets decreased three basis points to 6.89% for 2007 from 6.92% for 2006. Short-term market interest rates were very stable from August 2006 through July 2007. That stability positively impacted the rate earned on loans and securities, as new loan production and new securities purchased through September 2007 were being added at rates generally higher than those added in 2006. During the last four months of 2007, the Federal Reserve's target federal funds rate was decreased 100 basis points, and the average bank prime loan rate decreased in concert. Those decreases were the largest driver in the slight decrease in the Company's yield on average earning assets.

Total cost of average interest-bearing liabilities increased 39 basis points to 3.57% during 2007. The Company's time deposit portfolio experienced significant upward repricing during 2007, as many of the certificates written in a lower market rate environment matured and then repriced at a higher interest rate. The net result was a decrease of 42 basis points to net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities. Spread for 2007 was 3.32% compared with 3.74% for 2006. The Company's tax-equivalent net interest margin of 3.80% for 2007 represents a decrease of 42 basis points from 4.22% in 2006.

Loan interest income decreased \$3.94 million during 2007 as compared with 2006 as volume declined, while the yield on loans increased seven basis points. During 2007, the tax-equivalent yield on available-for-sale securities increased 27 basis points to 5.77% while the average balance increased by \$196.83 million as compared with 2006. The average tax-equivalent yield increased due to the addition of higher-rate securities and the sales, maturities, and calls of lower-rate securities.

Average interest-bearing balances with banks declined \$2.63 million during 2007 to \$24.66 million, while the yield increased 20 basis points to 4.76%. These balances include overnight liquidity and a small portfolio of time deposits purchased in 2002. The yield on these balances is largely affected by changes in the target federal funds rate.

The average total cost of interest-bearing deposits rose 40 basis points in 2007 compared with 2006. The average rate paid on interest-bearing demand deposits decreased one basis point, while the average rate paid on savings, which includes money market and savings accounts, increased 22 basis points. The Company was successful in keeping rates paid on interest-bearing checking accounts relatively stable and increased money market account rates to remain competitive and retain deposit funding. In 2007, average time deposits decreased \$17.62 million while the average

rate paid increased 54 basis points to 4.44% as compared with 2006. The level of average non interest-bearing demand deposits decreased \$9.13 million to \$228.58 million in 2007 compared with the prior year.

Average federal funds purchased and repurchase agreements increased \$72.29 million in 2007, due mostly to increases in the balances of repurchase agreements. The average rate paid on those funds also increased, as they are

## **Table of Contents**

closely tied to the target federal funds rate and 3-month LIBOR. Average Federal Home Loan Bank ( FHLB ) advances increased \$57.98 million while the rate paid on those borrowings increased one basis point in 2007. Other borrowings remained steady in 2007, but the rate paid increased 111 basis points because the majority of such borrowings consist of the Company's trust preferred borrowing, which is indexed to 3-month LIBOR.

### *Provision for Loan Losses*

The provision for loan losses for 2007 was \$717 thousand, a decrease of \$1.99 million when compared with 2006. The decrease in loan loss provision between the periods is primarily attributable to changes in specific allocations, decreases in commercial and consumer installment loan volume, reductions in net charge-offs, overall improved asset quality, and changes in various qualitative risk factors. Net charge-offs for 2007 and 2006 were \$2.43 million and \$2.89 million, respectively. Expressed as a percentage of average loans, net charge-offs decreased to 0.19% for 2007 from 0.22% in 2006.

### *Noninterest Income*

Noninterest income consists of all revenues which are not included in interest and fee income related to earning assets. Noninterest income for 2007 was \$24.83 million compared with \$21.32 million in 2006. Wealth management income, which includes fees for trust services and commission and fee income generated by IPC, increased \$1.07 million in 2007 compared with 2006, largely a result of the November 2006 acquisition of IPC.

Service charges on deposit accounts increased \$1.15 million as a result of increased transaction fees and a larger number of fee-based deposit accounts. Other service charges, commissions and fees reflected an increase of \$608 thousand in 2007 compared with 2006, due mainly to increased debit card interchange income and ATM service fees.

The Company acquired its insurance subsidiary, GreenPoint Insurance Group, Inc., in September 2007. Essentially all income for the insurance subsidiary is derived from commissions earned on the sale of policies. Since acquisition, commissions earned on the sale of policies by GreenPoint in 2007 were \$1.14 million.

Other operating income for 2007 includes a gain of \$298 thousand resulting from the Company's departure from a state banking association insurance operation. The Company was contractually required to exit the operation upon acquisition of GreenPoint. Other operating income for 2006 includes \$1.04 million in gains from the sale of branch locations, as well as a \$676 thousand recovery relating to a 1997 payment system fraud loss. The remaining components of other operating income increased \$621 thousand compared with 2006. During 2007, the Company also recognized securities gains of \$411 thousand, an increase of \$336 thousand over gains recognized in 2006.

### *Noninterest Expense*

Total noninterest expense was \$50.46 million for 2007, an increase of \$626 thousand over 2006. Salaries and benefits decreased approximately \$1.02 million due to the Company's efforts on expense control and efficiency and the implementation of a branch staffing model. During 2007, total full-time equivalent employees decreased to 615 from 624 at December 31, 2006. Full-time equivalent employees are calculated using the number of hours worked. Greenpoint accounted for approximately 51 full-time equivalent employees at year-end 2007. Total full-time equivalent employees at the Bank and IPC decreased by 60 compared with 2006.

Occupancy expenses increased \$112 thousand compared with 2006, as the Company opened new branches and acquired GreenPoint. Furniture and equipment expenses decreased \$96 thousand, due mainly to a decrease of \$90 thousand in depreciation and amortization expense from 2006 to 2007.

All other operating expense accounts increased \$1.63 million in 2007 compared with 2006. Contributing to the increase in operating expenses were increased new account promotions of \$245 thousand and consulting expense of \$728 thousand. In 2007, service fees related to clearing costs for IPC also increased \$339 thousand compared with 2006 and reflecting the full year impact in 2007. Professional fees also increased \$207 thousand in 2007 compared with 2006 as the Company outsourced its internal audit function near mid-year 2007.

## **Table of Contents**

### *Income Tax Expense*

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

Consolidated income taxes for 2007 were \$12.33 million, a 29.39% effective tax rate, compared with \$11.48 million, a 28.39% effective tax rate for 2006. The effective tax rate was higher during 2007 due mostly to lower levels of available tax credits than in 2006.

## **FINANCIAL POSITION**

### *Available-for-Sale Securities*

Available-for-sale securities were \$520.72 million at December 31, 2008, compared with \$664.12 million at December 31, 2007, a decrease of \$143.40 million. The decrease is result of lower security valuations and net portfolio reductions of \$29.27 million. At December 31, 2008, the average life and duration of the portfolio were 5.0 years and 3.6, respectively. Average life and duration improved from December 31, 2007, at 6.9 years and 4.7, respectively.

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, timing and amount of contractual cash flows, the expectation for that security's performance, the creditworthiness of the issuer and the Company's intent and ability to hold the security to recovery or maturity. A decline in value that is considered to be other-than-temporary would be recorded as a loss within noninterest income in the Consolidated Statements of Income.

As of December 31, 2008, the Company recognized a pre-tax non-cash impairment charge of \$14.47 million which stems from a 2006 vintage collateralized mortgage obligation. The Company's analysis of the bond showed probable losses of \$1.69 million, or 6.76%, of the \$25.00 million par value of the security. U.S. GAAP requires banks to write down securities with probable losses to estimated market values, irrespective of the portion of the loss in value attributable to credit quality.

The Company performed extensive cash flow analyses of each of its pooled trust preferred investment securities. As of December 31, 2008, one of the securities demonstrated probable adverse change in cash flow. This resulted in a pre-tax other-than-temporary impairment charge of \$15.46 million. Total pre-tax, non-cash impairment charges of \$29.92 million are reflected in non-interest income for the year ending December 31, 2008.

The Company does not believe any unrealized loss remaining in the investment portfolio, individually or in the aggregate, as of December 31, 2008, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Based on currently available information, the Company believes the recorded declines in the value of these securities at December 31, 2008 and 2007, are attributable to changes in market interest rates, a weakened outlook for the banking system, and the severe market dislocation experienced throughout 2008.

Included in available-for-sale securities is a portfolio of trust-preferred securities with a total market value of approximately \$66.05 million as of December 31, 2008. That portfolio is comprised of single-issue securities and pooled trust-preferred securities. The single-issue securities are trust-preferred issuances from large banking institutions, A-rated or higher, and had a total market value of approximately \$33.54 million as of December 31, 2008, compared with their adjusted cost basis of approximately \$55.49 million.

At December 31, 2008, the total market value of the pooled trust-preferred securities was approximately \$32.51 million, compared with an adjusted cost basis of approximately \$93.27 million. The collateral underlying these securities is comprised 86% of bank trust-preferred securities and subordinated debt issuances of over 500

**Table of Contents**

banks nationwide. The remaining collateral is from insurance companies and real estate investment trusts. The securities carry variable rate structures that float at a prescribed margin over 3-month LIBOR. During 2008, certain of these experienced a credit rating downgrade from one rating agency, and certain of these securities are on negative watch by one or more rating firms. The Company has modeled the expected cash flows from the pooled trust-preferred securities and, at present, does not expect any of the remaining securities to have an adverse cash flow effect under any of the scenarios modeled due to the existence of other subordinate classes within the pools.

The following table provides details regarding the type and credit ratings within the securities portfolios as of December 31, 2008. In the case of different ratings, the lower rating was utilized.

	<b>Par Value</b>	<b>Fair Value</b>	<b>Amortized Cost</b>	<b>Unrealized Gains/(Losses) Recognized in OCL</b>	<b>Cumulative OTTI</b>
	<b>(Amounts in thousands)</b>				
<b>Available for sale</b>					
Agency securities	\$ 53,435	\$ 54,818	\$ 53,425	\$ 1,393	\$
Agency mortgage-backed securities	211,203	216,962	212,315	4,647	
Non-Agency mortgage-backed securities:					
AAA	7,475	5,766	7,423	(1,657)	
B	25,000	10,750	10,750		14,467
Total	32,475	16,516	18,173	(1,657)	14,467
Municipals:					
AAA	6,738	6,716	6,729	(13)	
AA	62,885	62,056	62,926	(870)	
A	55,932	54,051	55,158	(1,107)	
BBB	31,610	30,280	31,500	(1,220)	
Not rated	6,720	6,316	6,729	(413)	
Total	163,885	159,419	163,042	(3,623)	
Single issuer bank trust preferred securities:					
AA	39,425	24,214	38,745	(14,531)	
A	17,130	9,327	16,747	(7,420)	
Total	56,555	33,541	55,492	(21,951)	
Pooled trust preferred securities:					
A	50,223	9,117	34,853	(25,736)	15,456
BBB	19,286	3,831	19,377	(15,546)	
BB	9,000	5,163	9,038	(3,875)	
B	30,000	14,401	30,000	(15,599)	
Total	108,509	32,512	93,268	(60,756)	15,456
Equity securities		6,955	7,979	(1,024)	
Total	\$ 626,062	\$ 520,723	\$ 603,694	\$ (82,971)	\$ 29,923



**Held to maturity**

Municipals:

AA	\$	3,680	\$	3,725	\$	3,664	\$	61	\$
A		4,050		3,859		3,792		67	
BBB		1,215		1,218		1,214		4	
Total	\$	8,945	\$	8,802	\$	8,670	\$	132	\$

Although the Company has both the intent and ability to hold the securities to maturity or recovery, the Company closely monitors this portfolio due to the substantial market discounts. The market discounts reflect the

**Table of Contents**

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 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 beyond those assumed in the Company's impairment testing. 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.

At December 31, 2008, the Company held separate issuances of trust preferred securities from one issuer which had book and market values of \$28.68 million and \$17.64 million, respectively.

The following table details amortized cost and fair value of available-for-sale securities as of December 31, 2008, 2007, and 2006.

	2008		December 31, 2007		2006	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Amounts in thousands)					
U.S. Government agency securities	\$ 53,425	\$ 54,818	\$ 136,791	\$ 139,237	\$ 117,777	\$ 116,061
States and political subdivisions	163,042	159,419	186,834	188,536	152,189	154,047
Single issuer trust preferred securities	55,491	33,542	55,422	51,549	41,545	41,419
Pooled trust preferred securities	93,269	32,511	109,309	99,076	43,535	43,614
Mortgage-backed securities	230,488	233,478	177,984	176,727	146,444	144,754
Equities	7,979	6,955	8,597	8,995	6,933	8,475
Total	\$ 603,694	\$ 520,723	\$ 674,937	\$ 664,120	\$ 508,423	\$ 508,370

***Held-to-Maturity Securities***

Investment securities classified as held-to-maturity are comprised primarily of high-grade state and municipal bonds. The portfolio totaled \$8.67 million at December 31, 2008, compared with \$12.08 million at December 31, 2007. This decrease is reflective of continuing maturities and calls within the portfolio. The market value of held-to-maturity investment securities was 101.52% and 101.85% of book value at December 31, 2008 and 2007, respectively.

The average final maturity of the held-to-maturity investment portfolio decreased to 4.3 years at December 31, 2008, from 5.5 years at December 31, 2007, with the tax-equivalent yield increasing to 7.97% at December 31, 2008, from 7.94% at year-end 2007. The weighted-average expected maturity, based on market assumptions for prepayment, was five months and six months at December 2008 and 2007, respectively. The average maturity data differs from final maturity data because of the use of assumptions as to anticipated prepayments, and is generally a more accurate

indicator of true average life of the investment.

**Table of Contents**

The following table details amortized cost and fair value of held-to-maturity securities at December 31, 2008, 2007, and 2006.

	2008		December 31, 2007		2006	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Amounts in thousands)					
States and political subdivisions	\$ 8,670	\$ 8,802	\$ 11,699	\$ 11,922	\$ 19,638	\$ 19,970
Corporate Notes			375	375	375	374
Mortgage-backed securities			1	1	6	6
Total	\$ 8,670	\$ 8,802	\$ 12,075	\$ 12,298	\$ 20,019	\$ 20,350

**Loans Held for Sale**

To mitigate interest rate risk, the Company sells most of the long-term, fixed-rate mortgage loans it originates in the secondary market. At December 31, 2008, the Company held \$1.02 million of loans for sale to the secondary market, up from \$811 thousand at December 31, 2007. The gross notional amount of outstanding commitments to originate mortgage loans for customers at December 31, 2008, was \$10.48 million on 71 loans. The Company sells these mortgages on a best-efforts basis and generates non-interest income through origination fees and yield spread gains.

**Loans Held for Investment**

Total loans held for investment increased \$72.66 million to \$1.30 billion at December 31, 2008, from \$1.23 billion at December 31, 2007, primarily as a result of the addition of \$136.99 million in Coddle Creek loans, which was partially offset by lower loan production and large payoffs throughout 2008. The average loan to deposit ratio decreased to 87.48% for 2008, compared with 89.02% for 2007. Average loans held for investment for 2008 of \$1.20 billion decreased \$51.95 million when compared with the average for 2007 of \$1.25 billion.

The held for investment loan portfolio continues to be diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition at year-end 2004 through 2008.

**Loan Portfolio Summary**

	2008	2007	December 31,		
			2006	2005	2004
	(Amounts in thousands)				
Commercial, financial and agricultural	\$ 85,034	\$ 96,261	\$ 106,645	\$ 110,211	\$ 99,302
Real estate commercial	407,638	386,112	421,067	464,510	453,899
Real estate construction	130,610	163,310	158,566	143,976	112,705
Real estate residential	602,573	498,345	506,370	504,387	457,417

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Consumer	66,259	75,450	88,679	106,206	113,639
Other	6,046	6,027	3,549	1,808	2,012
Total	1,298,160	1,225,505	1,284,876	1,331,098	1,238,974
Less unearned income	1	3	13	59	218
	1,298,159	1,225,502	1,284,863	1,331,039	1,238,756
Less allowance for loan losses	15,978	12,833	14,549	14,736	16,339
Net loans	\$ 1,282,181	\$ 1,212,669	\$ 1,270,314	\$ 1,316,303	\$ 1,222,417

**Table of Contents**

The Company maintained no foreign loans in the periods presented. Although the Company's loans are made primarily in the five-state region in which it operates, the Company had no concentrations of loans to one borrower or industry representing 10% or more of outstanding loans at December 31, 2008.

The following table details the maturities and rate sensitivity of the Company's loan portfolio at December 31, 2008.

	<b>Remaining Maturities</b>				<b>Total</b>	<b>Percent</b>
	<b>Over</b>	<b>One</b>	<b>One to</b>	<b>Over Five</b>		
	<b>Year</b>	<b>Five Years</b>	<b>Years</b>	<b>Years</b>		
	<b>and Less</b>					
	<b>(Amounts in thousands)</b>					
Commercial, financial and agricultural	\$ 12,648	\$ 56,876	\$ 15,510	\$ 85,034		6.55%
Real estate commercial	18,722	228,229	160,687	407,638		31.40%
Real estate construction	25,493	93,129	11,988	130,610		10.06%
Real estate mortgage	16,052	132,434	454,087	602,573		46.42%
Consumer	8,155	49,696	8,408	66,259		5.10%
Other	3,213	735	2,098	6,046		0.47%
	<b>\$ 84,283</b>	<b>\$ 561,099</b>	<b>\$ 652,778</b>	<b>\$ 1,298,160</b>		<b>100.00%</b>
<b>Rate Sensitivity:</b>						
Predetermined rate	\$ 36,920	\$ 409,711	\$ 331,262	\$ 777,893		59.92%
Floating- or adjustable-rate	47,363	151,388	321,516	520,267		40.08%
	<b>\$ 84,283</b>	<b>\$ 561,099</b>	<b>\$ 652,778</b>	<b>\$ 1,298,160</b>		<b>100.00%</b>

***Allowance for Loan Losses***

The allowance for loan losses is increased by charges to earnings in the form of provisions charged to current earnings and by recoveries of prior loan charge-offs, and decreased by loan charge-offs. The provisions are calculated to bring the allowance to a level, which, according to a systematic process of measurement, is reflective of the amount that management deems adequate to absorb probable losses. Additional information regarding the determination of the allowance for loan losses can be found in Note 1 of the Notes to Consolidated Financial Statements, included in Item 8 hereof.

The allowance for loan losses was \$15.98 million at December 31, 2008, compared with \$12.83 million at December 31, 2007, an increase of \$3.15 million. The increase in the allowance was primarily influenced by the affect of net charge-off activity during the year, which totaled \$5.45 million as of December 31, 2008, as compared to \$2.43 million as of December 31, 2007, on provision expense. Three loan relationships accounted for approximately \$1.8 million of total 2008 net charge-offs. The three relationships had been previously identified as impaired by management with a combined specific reserve allocation established equivalent to the amount charged-off. Collection activity continues on all three relationships. Additionally, the allowance methodology takes into consideration trends in delinquency and non-accrual loans; both of which exhibited an increasing trend during the year. Management considers the allowance adequate based upon its analysis of the portfolio as of December 31, 2008; however, no assurance can be made that additions to the allowance for loan losses will not be required in future periods.



**Table of Contents**

The following table details loan charge-offs and recoveries by loan type for the five years ended December 31, 2004 through 2008.

	2008	Years Ended December 31,			2004
		2007	2006	2005	
		(Dollars in thousands)			
Allowance for loan losses at beginning of period	\$ 12,833	\$ 14,549	\$ 14,736	\$ 16,339	\$ 14,624
Acquisition balances	1,169				1,786
Charge-offs:					
Commercial, financial, agricultural and commercial real estate	4,349	2,245	1,953	5,017	1,925
Real estate-residential	1,200	824	1,234	385	723
Installment	1,822	1,226	1,356	1,534	1,526
Total charge-offs	7,371	4,295	4,543	6,936	4,174
Recoveries:					
Commercial, financial and agricultural	1,388	879	1,032	1,413	727
Real estate-residential	76	535	125	188	90
Installment	461	448	493	418	615
Total recoveries	1,925	1,862	1,650	2,019	1,432
Net charge-offs	5,446	2,433	2,893	4,917	2,742
Provision charged to operations	7,422	717	2,706	3,706	2,671
Reclassification of allowance for lending-related commitments(1)				(392)	
Allowance for loan losses at end of period	\$ 15,978	\$ 12,833	\$ 14,549	\$ 14,736	\$ 16,339
Ratio of net charge-offs to average loans outstanding	0.45%	0.19%	0.22%	0.38%	0.24%
Ratio of allowance for loan losses to total loans outstanding	1.23%	1.05%	1.13%	1.11%	1.32%

(1) At June 30, 2005, the Company reclassified \$392 thousand of its allowance for loan losses to a separate allowance for lending-related liabilities. Net income and prior period balances were not affected by this reclassification. The allowance for lending-related liabilities is included in other liabilities.

The following table details the allocation of the allowance for loan losses and the percent of loans in each category to total loans for the five years ended December 31, 2008.

2008	2007	December 31, 2006	2005	2004
------	------	----------------------	------	------



**(Dollars in thousands)**

Commercial, financial and agricultural	\$ 6,442	48%	\$ 7,441	53%	\$ 8,418	53%	\$ 9,993	58%	\$ 11,700	57%
Real estate mortgage	7,038	46%	3,699	41%	3,858	39%	2,462	34%	2,084	34%
Consumer	2,025	6%	1,693	6%	2,273	8%	2,281	8%	2,555	9%
Unallocated	473									
Total	\$ 15,978	100%	\$ 12,833	100%	\$ 14,549	100%	\$ 14,736	100%	\$ 16,339	100%

**Table of Contents****Risk Elements**

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. The levels of non-performing assets for the last five years ending December 31, 2008, are presented in the following table.

	<b>December 31,</b>				
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Non-accrual loans	\$ 12,763	\$ 2,923	\$ 3,813	\$ 3,383	\$ 5,168
Loans 90 days or more past due and still accruing interest				11	
Total non-performing loans	12,763	2,923	3,813	3,394	5,168
Other real estate owned	1,326	545	258	1,400	1,419
Total non-performing assets	\$ 14,089	\$ 3,468	\$ 4,071	\$ 4,794	\$ 6,587
Non-performing loans as a percentage of total loans	0.98%	0.24%	0.30%	0.25%	0.42%
Non-performing assets as a percentage of total loans and other real estate owned	1.08%	0.28%	0.32%	0.36%	0.53%
Allowance for loan losses as a percentage of non-performing loans	125.2%	439.0%	381.6%	434.2%	316.2%
Allowance for loan losses as a percentage of non-performing assets	113.4%	370.0%	357.4%	307.4%	248.0%

Total non-performing assets were \$14.09 million at December 31, 2008, compared with \$3.47 million at December 31, 2007, an increase of \$10.62 million. Non-accrual loans increased by \$9.84 million to \$12.76 million at December 31, 2008, compared with 2007. The increase in non-accrual loans was largely driven by the addition of two commercial loan relationships and the Coddle Creek acquisition. The first of the two commercial loan relationships is a \$2.92 million hotel loan secured by a hotel facility in North Carolina. The bank has established a specific reserve allocation based upon its impairment analysis and anticipates liquidation of the collateral to be completed late in the first quarter. The second commercial loan relationship is to a commercial and residential land developer in the Richmond, Virginia, area that is principally comprised of three loans totaling \$2.41 million. The bank had previously evaluated the loans for impairment and had established specific reserve allocations accordingly. At year-end, the loans were written down in amount equivalent to the specific allocation. Liquidation of two of the loans is anticipated to be completed late in the first quarter. Approximately \$2.81 million in non-accrual loans were acquired in the Coddle Creek loan portfolio, with the largest non-accrual loan totaling \$261 thousand. The non-accrual loan balance was anticipated as a result of pre-acquisition due diligence.

Ongoing activity within the classification and categories of non-performing loans continues to include collections on delinquent loans, foreclosures, and movements into or out of the non-performing classification as a result of changing customer business conditions. There were no loans 90 days past due and still accruing at December 31, 2008 and 2007. Other real estate owned increased \$781 thousand to \$1.33 million at December 31, 2008, and is carried at the lesser of estimated net realizable value or cost.

Certain loans included in the non-accrual category have been written down to the estimated realizable value or have been assigned specific reserves within the allowance for loan losses based upon management's estimate of loss upon ultimate resolution.

The Company has considered all impaired loans in the evaluation of the adequacy of the allowance for loan losses at December 31, 2008. The following table presents additional detail of non-performing and restructured

**Table of Contents**

loans for the five years ended December 31, 2008. Additional information regarding nonperforming loans can be found in Note 5 of the Notes to Consolidated Financial Statements, included in Item 8 hereof.

	2008	2007	December 31,		2004
			2006	2005	
			(Amounts in thousands)		
Non-accruing loans	\$ 12,763	\$ 2,923	\$ 3,813	\$ 3,383	\$ 5,168
Loans past due over 90 days and still accruing interest				11	
Restructured loans performing in accordance with modified terms	113	245	272	302	354
Gross interest income which would have been recorded under original terms of non-accruing and restructured loans	458	301	397	380	439
Actual interest income during the period	89	179	286	161	293

There are no outstanding commitments to lend additional funds to borrowers related to restructured loans.

**Deposits**

Total deposits were \$1.50 billion at December 31, 2008, an increase of \$110.32 million from \$1.39 billion at December 31, 2007. \$137.06 million of the increase is attributable to the acquisition of Coddle Creek. Noninterest-bearing demand deposits decreased during 2008 by \$24.38 million while interest-bearing demand deposits increased \$31.55 million. Savings deposits, which consist of money market accounts and savings accounts, decreased \$18.11 million during 2008 while time deposits increased \$121.26 million, primarily attributable to Coddle Creek. Movement among product types during the year reflects a general migration toward interest-bearing and higher yielding account types as customers searched for yield opportunities in a falling rate environment.

Average total deposits decreased slightly to \$1.37 billion for 2008. Average interest-bearing demand deposits increased \$26.95 million during 2008. Average noninterest-bearing demand deposits and savings deposits decreased \$16.79 million and \$18.61 million during 2008, respectively. Average time deposits decreased \$26.27 million in 2008. In 2008, the average rate paid on interest bearing deposits was 2.57%, down 72 basis points from 3.29% in 2007. Throughout 2008, the Company decreased its higher-rate certificates of deposit and money market accounts. The increase in interest-bearing demand deposits can be attributed to growth in the Company's fee-based, interest-bearing checking accounts and associated rewards program.

**Borrowings**

The Company's borrowings consist primarily of overnight federal funds purchased from the FHLB and other sources, securities sold under agreements to repurchase, and term FHLB borrowings. This category of liabilities represents wholesale sources of funding and liquidity for the Company.

Short-term borrowings decreased on average approximately \$14.03 million for 2008 compared with the prior year as a result of decreasing funding needs. There were no federal funds purchased at December 31, 2008, and \$18.50 million, at December 31, 2007. Repurchase agreements were \$165.91 million and \$207.43 million at December 31, 2008 and 2007, respectively. Retail repurchase agreements are sold to customers as an alternative to available deposit products and commercial treasury accounts. At December 31, 2008 and 2007, wholesale repurchase agreements totaled

\$50.00 million. The weighted-average rate of those long-term, wholesale repurchase agreements was 4.32% and 4.30% at December 31, 2008 and 2007, respectively. The underlying securities included in retail repurchase agreements remain under the Company's control during the effective period of the agreements.

**Table of Contents**

Short-term borrowings include overnight federal funds and repurchase agreements. Balances and rates paid on short-term borrowings used in daily operations are summarized as follows:

	2008		2007		2006	
	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)					
At year-end	\$ 165,914	2.36%	\$ 225,927	4.32%	\$ 208,885	3.70%
Average during the year	209,101	2.40%	223,132	3.72%	150,839	3.37%
Maximum month-end balance	282,110		273,920		208,885	

At December 31, 2008, FHLB borrowings included \$200.00 million in convertible and callable advances. The weighted-average interest rate of all advances was 3.70% and 4.38% at December 31, 2008 and 2007, respectively. \$50.00 million of the advances are hedged by an interest rate swap to approximate a fixed rate of 4.34%. After considering the effect of the interest rate swap, the weighted-average interest rate of all advances was 3.84% at December 31, 2008. At December 31, 2008, the FHLB advances had maturities between eight and thirteen years.

Also included in other indebtedness is \$15.46 million of junior subordinated debentures issued by the Company in October 2003 through FCBI Capital Trust, an unconsolidated trust subsidiary, with an interest rate of three-month LIBOR plus 2.95%. The debentures mature in October 2033 and are currently callable.

**Liquidity and Capital Resources**

Liquidity represents the Company's ability to respond to demands for funds and is primarily derived from maturing investment securities, overnight investments, periodic repayment of loan principal, and the Company's ability to generate new deposits. The Company also has the ability to attract short-term sources of funds and draw on credit lines that have been established at financial institutions to meet cash needs.

Total liquidity of \$392.34 million at December 31, 2008, is comprised of the following: cash on hand and deposits with other financial institutions of \$46.44 million; unpledged available-for-sale securities of \$143.17 million; held-to-maturity securities due within one year of \$452 thousand; FHLB credit availability of \$106.28 million; federal funds lines availability of \$76.00 million; and holding company line of credit availability of \$20.00 million. As a result of the continuing national credit crisis which developed in 2008, the Company's FHLB credit availability declined as the FHLB increased collateral pledging requirements.

Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally used to pay down short-term borrowings. On a longer-term basis, the Company maintains a strategy of investing in securities, mortgage-backed obligations and loans with varying maturities. The Company uses these funds to meet ongoing commitments, to pay maturing savings certificates and savings withdrawals, fund loan commitments and maintain a portfolio of securities.

Since the Company is a holding company and does not conduct operations, its primary sources of liquidity are dividends upstreamed from the Bank and borrowings from outside sources. Banking regulations limit the amount of dividends that may be paid by the Bank. See Note 15 Regulatory Capital Requirements and Restrictions of the Notes to Consolidated Financial Statements included in Item 8 hereof regarding such dividends. At December 31, 2008, the Company had liquid assets, including cash and investment securities, totaling \$13.65 million, and a holding company line of credit of \$20.00 million. Additionally, as a result of the Company's participation in the TARP Capital Purchase Program, the ability of the Company to declare or pay dividends or distributions on shares of its Common Stock is

subject to restrictions, including a restriction against increasing cash dividends above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008, which was \$0.28 per share, without the express permission of the Treasury. These restrictions will terminate on the earlier of (a) the third anniversary of the date of issuance of the Series A Preferred Stock and (b) the date on which the Series A Preferred Stock has been redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock to third parties.

At December 31, 2008, approved loan commitments outstanding amounted to \$167.32 million. Certificates of deposit scheduled to mature in one year or less totaled \$515.74 million. Management believes that the Company has adequate resources to fund outstanding commitments and could either adjust rates on certificates of deposit in order

**Table of Contents**

to retain or attract deposits in changing interest rate environments or replace such deposits with advances from the FHLB or other funds providers if it proved to be cost effective to do so.

The following table presents contractual cash obligations as of December 31, 2008.

	<b>Total</b>	<b>Total Payments Due by Period</b>			
		<b>Less than One year</b>	<b>One to Three Years</b>	<b>Three to Five Years</b>	<b>More than Five Years</b>
		(Amounts in thousands)			
Deposits without a stated maturity(1)	\$ 694,406	\$ 694,406	\$	\$	\$
Federal funds borrowed and overnight security repurchase agreements	87,682	87,682			
Certificates of Deposit(2)(3)	841,411	535,076	175,445	56,617	74,273
Term security repurchase agreements	96,990	23,518	5,597	11,679	56,196
FHLB advances(2)(3)	285,904	8,400	17,085	17,378	243,041
Trust preferred indebtedness	45,706	1,218	2,436	2,848	39,204
Leases	2,599	762	1,027	626	184
<b>Total</b>	<b>\$ 2,054,698</b>	<b>\$ 1,351,062</b>	<b>\$ 201,590</b>	<b>\$ 89,148</b>	<b>\$ 412,898</b>

(1) Excludes interest.

(2) Includes interest on both fixed and variable-rate obligations. The interest associated with variable-rate obligations is based upon interest rates in effect at December 31, 2008. The interest to be paid on variable-rate obligations is affected by changes in market interest rates, which materially affect the contractual obligation amounts to be paid.

(3) Excludes carrying value adjustments such as unamortized premiums or discounts.

The following table presents detailed information regarding the Company's off-balance sheet arrangements at December 31, 2008.

	<b>Amount of Commitment Expiration Per Period</b>			
	<b>Less than One Year</b>	<b>One to Three Years</b>	<b>Three to Five Years</b>	<b>More than Five Years</b>
	(Amounts in thousands)			
<b>Total</b>	<b>(1)</b>			
\$ 24,767	\$ 8,095	\$ 12,303	\$ 1,109	\$ 3,260



Commitments to extend credit					
Commercial, financial and agricultural					
Real estate commercial	16,471	2,304	12,111	563	1,493
Real estate residential	78,077	1,463	5,513	6,166	64,935
Real estate construction	31,494	4,859	15,146	7,523	3,966
Consumer lines of credit	48,338	47,838	483	2	15
Other	146		146		
Total unused commitments	\$ 199,293	\$ 64,559	\$ 45,702	\$ 15,363	\$ 73,669
Financial letters of credit	\$ 1,493	\$ 946	\$ 530	\$ 7	\$ 10
Performance letters of credit	1,351	323	944	20	64
Total letters of credit	\$ 2,844	\$ 1,269	\$ 1,474	\$ 27	\$ 74

(1) Lines of credit with no stated maturity date are included in commitments for less than one year.

## **Table of Contents**

The Company has a pay fixed and receive variable interest rate swap that effectively fixes \$50.00 million of FHLB borrowings at 4.34% for a period of five years. The derivative transaction is effective and performing as originally expected.

### ***Stockholders Equity***

Total stockholders equity increased \$3.24 million to \$220.34 million at December 31, 2008. The increase in equity in 2008 was due mainly to comprehensive net loss of \$42.15 million less preferred and common dividends of \$255 thousand and \$12.45 million, respectively, and net additions of treasury stock at a cost of \$1.76 million. Issuance of the Series A Preferred Stock to the Treasury added \$40.42 million, net, to stockholders equity, and the acquisition of Coddle Creek added approximately \$19.14 million.

Risk-based capital guidelines and the leverage ratio measure capital adequacy of banking institutions. At December 31, 2008, the Company's Tier I capital ratio was 11.92% compared with 11.45% in 2007. The Company's total risk-based capital-to-asset ratio was 12.91% at December 31, 2008, compared with 12.34% at December 31, 2007. Both of these ratios are well above the current minimum level of 8% prescribed for bank holding companies by the Federal Reserve Board. The leverage ratio is the measurement of total tangible equity to total assets. The Company's leverage ratio at December 31, 2008, was 9.75% versus 8.09% at December 31, 2007, both of which are well above the minimum levels prescribed by the Federal Reserve Board. See Note 15 of the Notes to Consolidated Financial Statements in Item 8 hereof.

### ***Wealth Management Services***

As part of its community banking services, the Company offers trust management and estate administration services through its Trust and Financial Services Division (Trust Division). The Trust Division reported market value of assets under management of \$416 million and \$480 million at December 31, 2008 and 2007, respectively. The decrease in assets under management is largely due to decreases in the market value of account assets throughout 2008. The Trust Division manages inter vivos trusts and trusts under will, develops and administers employee benefit plans and individual retirement plans and manages and settles estates. Fiduciary fees for these services are charged on a schedule related to the size, nature and complexity of the account.

The Company also offers investment advisory services through the Bank's wholly-owned subsidiary, IPC, which reported assets under management of \$432 million and \$360 million at December 31, 2008 and 2007, respectively. The increase over 2007 includes the addition of several large accounts. IPC utilizes the Raymond James investment platform, which provides all settlement and clearing services.

### ***Insurance Services***

The Company offers insurance services through its subsidiary GreenPoint. Revenues are derived mainly from commissions paid on policies sold. Commission revenue was \$4.99 million for 2008 compared to \$1.14 million for 2007. The Company acquired GreenPoint late in 2007. GreenPoint is an acquisitive agency taking advantage of a number of local independent insurance agencies with principals evaluating exit strategies. GreenPoint made two large acquisitions during 2008, REL Insurance in Greensboro, North Carolina, and Carr & Hyde in Warrenton, Virginia. Those two agencies added combined annualized revenues of over \$3 million.

**Table of Contents**

**ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.***

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 its interest-earning assets reprice differently than its 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 including 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 the result of embedded options, often called 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 (IRR) exposure to insulate net interest income and net earnings from fluctuations in the general level of interest rates. To measure its exposure to IRR, 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 results of these simulations indicate the existence and severity of IRR 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, management's estimate of yields to be attained in those future rate environments, and rates that will be paid on various deposit instruments and borrowings. Specific strategies for management of IRR have included shortening the amortized maturity of new fixed-rate loans, increasing the volume of adjustable-rate loans to reduce the repricing term of the Bank's interest-earning assets, and monitoring the term structure of liabilities to maintain a balanced mix of maturity and repricing to mitigate the potential exposure. 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. Based upon the latest simulation, the Company believes that it is in a neutral sensitivity position.

The Company has established policy limits for tolerance of interest rate risk that allow for no more than a 10% reduction in the next twelve months' projected net interest income based on the income simulation compared with forecasted results. 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.

**Table of Contents**

The following table summarizes the impact of immediate and sustained rate shocks in the interest rate environment on net interest income and the economic value of equity as of December 31, 2008 and 2007. The model simulates plus and minus 200 basis point changes from the base case rate simulation. This table, which illustrates the prospective effects of hypothetical interest rate changes, is based upon numerous assumptions including relative and estimated levels of key interest rates over a twelve-month time period. This modeling technique, although useful, does not take into account all strategies that management might undertake in response to a sudden and sustained rate shock as depicted. Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other internal and external variables. As of December 31, 2008, the Federal Open Market Committee set a target range for federal funds of 0 to 25 basis points, rendering a complete downward shock of 200 basis points as not realistic and not meaningful. In the downward rate shocks presented, benchmark interest rates are dropped with floors near 0%.

**Rate Sensitivity Analysis**

Increase (Decrease) in Interest Rates (Basis Points)	2008		Change in	
	Change in Net Interest Income	% Change	Market Value of Equity	% Change
			(Dollars in thousands)	
200	\$ 1,479	2.3	\$ (8,040)	(3.7)
100	1,493	2.3	719	0.3
(100)	1,874	2.9	(21,443)	(9.9)

Increase (Decrease) in Interest Rates (Basis Points)	2007		Change in	
	Change in Net Interest Income	% Change	Market 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)

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

Consolidated Financial Statements	
<u>Consolidated Balance Sheets</u>	47
<u>Consolidated Statements of Income</u>	48
<u>Consolidated Statements of Cash Flows</u>	49
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	50
<u>Notes to Consolidated Financial Statements</u>	51
<u>Reports of Independent Registered Public Accounting Firms on Consolidated Financial Statements</u>	87
<u>Management's Assessment of Internal Control Over Financial Reporting</u>	88
<u>Report of Independent Registered Public Accounting Firm on Management's Assessment of Internal Control Over Financial Reporting</u>	89

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****CONSOLIDATED BALANCE SHEETS**

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Amounts in thousands, except share and per share data)</b>	
<b>ASSETS</b>		
Cash and due from banks	\$ 39,310	\$ 50,051
Interest-bearing balances with banks	7,129	2,695
Total cash and cash equivalents	46,439	52,746
Securities available for sale (amortized cost of \$603,694, 2008; \$674,937, 2007)	520,723	664,120
Securities held to maturity (fair value of \$8,802, 2008; \$12,298, 2007)	8,670	12,075
Loans held for sale	1,024	811
Loans held for investment, net of unearned income	1,298,159	1,225,502
Less allowance for loan losses	15,978	12,833
Net loans held for investment	1,282,181	1,212,669
Premises and equipment, net	55,024	48,383
Other real estate owned	1,326	545
Interest receivable	10,084	12,465
Goodwill	83,192	66,310
Other intangible assets	6,420	3,746
Other assets	118,231	75,968
Total Assets	\$ 2,133,314	\$ 2,149,838
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 199,712	\$ 224,087
Interest-bearing	1,304,046	1,169,356
Total Deposits	1,503,758	1,393,443
Interest, taxes and other liabilities	27,423	21,454
Federal funds purchased		18,500
Securities sold under agreements to repurchase	165,914	207,427
FHLB borrowings and other indebtedness	215,877	291,916
Total Liabilities	1,912,972	1,932,740
<b>Stockholders Equity</b>		
Preferred stock, par value undesignated; 1,000,000 shares authorized; 41,500 shares issued and outstanding in 2008 and none in 2007	40,419	

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Common stock, \$1 par value; shares authorized: 25,000,000; shares issued: 12,051,234 in 2008 and 11,499,018 in 2007; shares outstanding: 11,567,449 in 2008 and 11,069,646 in 2007	12,051	11,499
Additional paid-in capital	128,526	108,825
Retained earnings	107,231	117,670
Treasury stock, at cost	(15,368)	(13,613)
Accumulated other comprehensive loss	(52,517)	(7,283)
 Total Stockholders' Equity	 220,342	 217,098
 Total Liabilities and Stockholders' Equity	 \$ 2,133,314	 \$ 2,149,838

See Notes to Consolidated Financial Statements.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME**

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands, except share and per share data)</b>		
Interest Income			
Interest and fees on loans	\$ 80,224	\$ 93,501	\$ 97,460
Interest on securities-taxable	22,714	24,725	13,951
Interest on securities-nontaxable	7,521	8,190	7,371
Interest on federal funds sold and deposits in banks	306	1,175	1,244
<b>Total interest income</b>	<b>110,765</b>	<b>127,591</b>	<b>120,026</b>
Interest Expense			
Interest on deposits	29,792	38,757	33,868
Interest on short-term borrowings	5,252	9,760	6,977
Interest on long-term debt	9,886	10,759	7,536
<b>Total interest expense</b>	<b>44,930</b>	<b>59,276</b>	<b>48,381</b>
<b>Net Interest Income</b>	<b>65,835</b>	<b>68,315</b>	<b>71,645</b>
Provision for loan losses	7,422	717	2,706
<b>Net interest income after provision for loan losses</b>	<b>58,413</b>	<b>67,598</b>	<b>68,939</b>
Noninterest Income			
Wealth management income	4,100	3,880	2,811
Service charges on deposit accounts	14,067	11,387	10,242
Other service charges, commissions and fees	4,248	3,600	2,992
Insurance commissions	4,988	1,142	
Investment securities impairments	(29,923)		
Net gains on sale of securities	1,899	411	75
Other operating income	2,995	4,411	5,203
<b>Total noninterest income</b>	<b>2,374</b>	<b>24,831</b>	<b>21,323</b>
Noninterest Expense			
Salaries and employee benefits	29,876	25,848	26,867
Occupancy expense of bank premises	5,102	4,180	4,068
Furniture and equipment expense	3,740	3,370	3,466
Prepayment penalties on FHLB advances	1,647		
Other operating expense	20,151	17,065	15,436
<b>Total noninterest expense</b>	<b>60,516</b>	<b>50,463</b>	<b>49,837</b>



Income before income taxes	271	41,966	40,425
Income tax (benefit) expense	(2,810)	12,334	11,477
Net income	3,081	29,632	28,948
Dividends on preferred stock	255		
Net income available to common shareholders	\$ 2,826	\$ 29,632	\$ 28,948
Basic earnings per common share	\$ 0.26	\$ 2.64	\$ 2.58
Diluted earnings per common share	\$ 0.25	\$ 2.62	\$ 2.57
Dividends declared per common share	\$ 1.12	\$ 1.08	\$ 1.04
Weighted average basic shares outstanding	11,058,076	11,204,676	11,204,875
Weighted average diluted shares outstanding	11,134,025	11,292,871	11,279,480

See Notes to Consolidated Financial Statements.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands)</b>		
Cash flows from operating activities			
Net income	\$ 3,081	\$ 29,632	\$ 28,948
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	7,422	717	2,706
Depreciation and amortization of premises and equipment	3,885	3,276	3,366
Intangible amortization	689	467	410
Net investment amortization and accretion	(161)	534	699
Gains on the sale of assets	(1,839)	(357)	(1,329)
Mortgage loans originated for sale	(32,704)	(42,598)	(33,565)
Proceeds from sale of mortgage loans	32,672	42,822	34,243
Gain on sale of loans	(181)	(254)	(185)
Equity-based compensation expense	260	271	427
Deferred income tax (benefit) expense	(12,647)	216	465
Decrease (increase) in interest receivable	3,071	(324)	(1,928)
Excess tax benefit from stock-based compensation	(85)	(327)	(201)
Prepayment penalty	1,647		
(Increase) decrease in other assets	32,534	(3,407)	215
Increase in other liabilities	(41)	1,781	769
Net cash provided by operating activities	37,603	32,449	35,040
Cash flows from investing activities			
Proceeds from sales of securities available for sale	128,888	12,010	14,185
Proceeds from maturities and calls of securities available for sale	87,144	28,635	23,515
Proceeds from maturities and calls of held to maturity securities	3,417	7,907	4,221
Purchase of securities available for sale	(171,446)	(211,321)	(139,624)
Purchase of bank-owned life insurance			(25,000)
Net decrease (increase) in loans made to customers	58,473	56,623	40,610
Cash used in divestitures and acquisitions, net	(4,661)	(5,364)	(22,046)
Purchase of premises and equipment	(6,040)	(15,160)	(5,709)
Proceeds from sale of equipment	21	526	402
Net cash used in investing activities	95,796	(126,144)	(109,446)
Cash flows from financing activities			
Net (decrease) increase in demand and savings deposits	(52,079)	2,158	(17,215)
Net increase (decrease) in time deposits	24,788	(3,649)	35,551
Net increase (decrease) in FHLB and other borrowings	(76,039)	93,272	68,440
Prepayment penalty	(1,647)		

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Net increase (decrease) in federal funds purchased	(18,500)	10,800	(74,800)
Net (decrease) increase in securities sold under agreement to repurchase	(41,513)	6,242	77,369
Net proceeds from the issuance of preferred stock	41,409		
Proceeds from the exercise of stock options	464	781	1,305
Excess tax benefit from stock-based compensation	85	327	201
Acquisition of treasury stock	(4,222)	(9,170)	(4,566)
Dividends paid	(12,452)	(12,079)	(11,659)
Net cash provided by financing activities	(139,706)	88,682	74,626
Net increase (decrease) in cash and cash equivalents	(6,307)	(5,013)	220
Cash and cash equivalents at beginning of year	52,746	57,759	57,539
Cash and cash equivalents at end of year	\$ 46,439	\$ 52,746	\$ 57,759
Supplemental information Noncash items			
Transfers of loans to other real estate	\$ 2,653	\$ 1,342	\$ 1,281

(See Note 1 for detail of income taxes and interest paid and Note 2 for supplemental information regarding detail of cash paid in acquisitions.)

See Notes to Consolidated Financial Statements

Table of Contents**FIRST COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive (Loss) Income	Total
	(Amounts in thousands, except share and per share information)						
Balance January 1, 2006	\$	\$ 11,496	\$ 108,573	\$ 82,828	\$ (7,625)	\$ (771)	\$ 194,501
Comprehensive income:							
Net income				28,948			28,948
Other comprehensive income							
Change in unrealized gain on securities available for sale of \$1,242, net of \$497 tax expense						745	745
Less reclassification adjustment for losses realized in net income of \$10, net of \$4 tax benefit						(6)	(6)
Unrealized gain on derivative securities of \$441, net of \$177 tax expense						264	264
Total comprehensive income, net of tax				28,948		1,003	29,951
Common dividends declared (\$1.04 per share)				(11,659)			(11,659)
Purchase of 145,161 treasury shares at \$31.46 per share					(4,566)		(4,566)
Acquisition of Stone Capital Management (2,706 shares)		3	85				88
Acquisition of Investment Planning Consultants (39,874 shares)			217		1,248		1,465
Distribution of treasury stock for ESOP (27,733 shares)			16		867		883
Equity-based compensation			267		160		427
Tax benefit from exercise of stock options			335				335
Table of Contents							92

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Common stock options exercised (63,655 shares)		(687)		1,992		1,305
Balance December 31, 2006	11,499	108,806	100,117	(7,924)	232	212,730
Comprehensive income:						
Net income			29,632			29,632
Other comprehensive income						
Change in unrealized loss on securities available for sale of \$11,028, net of \$4,411 tax benefit					(6,617)	(6,617)
Less reclassification adjustment for gains realized in net income of \$263, net of \$105 tax expense					158	158
Unrealized loss on derivative securities of \$1,760, net of \$704 tax benefit					(1,056)	(1,056)
Total comprehensive income, net of tax			29,632		(7,515)	22,117
Common dividends declared (\$1.08 per share)			(12,079)			(12,079)
Purchase of 287,500 treasury shares at \$31.89 per share				(9,170)		(9,170)
Acquisition of GreenPoint Insurance Group (49,088 shares)		133		1,524		1,657
Acquisition of Investment Planning Consultants (13,401 shares)		30		425		455
Equity-based compensation		169		102		271
Tax benefit from exercise of stock options		336				336
Common stock options exercised (45,665 shares)		(649)		1,430		781
Balance December 31, 2007	11,499	108,825	117,670	(13,613)	(7,283)	217,098
Comprehensive income:						
Net income			3,081			3,081
Other comprehensive income						
Change in unrealized loss on securities available for					(61,382)	(61,382)

sale of \$100,626, net of \$39,244 tax benefit								
Reclassification adjustment for net losses realized in net income of \$29,607, net of \$11,547 tax expense						18,060		18,060
Change in unrealized loss on derivative securities of \$1,974, net of \$770 tax benefit						(1,204)		(1,204)
Change related to employee benefit plans of \$1,161, net of \$453 tax benefit						(708)		(708)
Total comprehensive income, net of tax				3,081		(45,234)		(42,153)
Cumulative effect of change in accounting principle				(813)				(813)
Preferred stock issuance, net	40,395		(91)					40,304
Common stock warrant issuance			1,105					1,105
Preferred dividend, net	24			(255)				(231)
Common dividends declared (\$1.12 per share)				(12,452)				(12,452)
Purchase of 132,100 treasury shares at \$31.96 per share						(4,222)		(4,222)
Acquisition of Coddle Creek (552,216 shares)		552	18,588					19,140
Acquisition of GreenPoint Insurance Group (7,728 shares)			22			245		267
Acquisition of Investment Planning Consultants (8,361 shares)			(26)			266		240
Contribution of treasury stock to 401(k) plan (37,775 shares)			8			1,200		1,208
Equity-based compensation			244			16		260
Tax benefit from exercise of stock options			127					127
Common stock options exercised (22,323 shares)			(276)			740		464
Balance December 31, 2008	\$ 40,419	\$ 12,051	\$ 128,526	\$ 107,231	\$ (15,368)	\$ (52,517)	\$ 220,342	

See Notes to Consolidated Financial Statements



**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS****Note 1. Summary of Significant Accounting Policies*****Basis of Presentation***

The accounting and reporting policies of First Community Bancshares, Inc. and subsidiaries ( First Community or the Company ) conform to accounting principles generally accepted in the United States and to predominant practices within the banking industry. In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. Assets held in an agency or fiduciary capacity are not assets of the Company and are not included in the accompanying consolidated balance sheets.

***Principles of Consolidation***

The consolidated financial statements of First Community include the accounts of all wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Effective January 1, 2008, the Company operates within two business segments, community banking and insurance services.

***Use of Estimates***

In preparing consolidated financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Financial statement items requiring the significant use of estimates and assumptions include, but are not limited to, fair values of investment securities and the allowance for loan losses. Actual results could differ from those estimates.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash and due from banks, time deposits with other banks, federal funds sold, and interest-bearing balances on deposit with the Federal Home Loan Bank ( FHLB ) that are available for immediate withdrawal. Interest and income taxes paid were as follows:

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands)</b>		
Interest	\$ 46,381	\$ 58,797	\$ 46,241
Income Taxes	8,777	12,097	9,717

Pursuant to agreements with the Federal Reserve Bank, the Company maintains a cash balance of approximately \$1.0 million in lieu of charges for check clearing and other services.

***Trading Securities***



At December 31, 2008 and 2007, no securities were held for trading purposes and no trading account was maintained.

***Investment Securities***

Securities to be held for indefinite periods of time, including securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, changes in prepayment risk, or other similar factors, are classified as available-for-sale and are recorded at estimated fair value. Unrealized appreciation or depreciation in fair value above or below amortized cost is included in stockholders' equity, net of income taxes, and is entitled Other Comprehensive Income (Loss). Premiums and discounts are

**Table of Contents**

**FIRST COMMUNITY BANCSHARES, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

amortized to expense or accreted to income over the life of the security. Gain or loss on sale is based on the specific identification method.

Investments in debt securities that management has the ability and intent to hold to maturity are carried at amortized cost. Premiums and discounts are amortized to expense and accreted to income over the lives of the securities. Gain or loss on the call or maturity of investment securities, if any, is recorded based on the specific identification method.

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, as amended, 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.

***Loans Held for Sale***

Loans held for sale primarily consist of one-to-four family residential loans originated for sale in the secondary market and are carried at the lower of cost or estimated fair value determined on an aggregate basis. The long-term, fixed-rate loans are sold to investors on a best efforts basis such that the Company does not absorb the interest rate risk involved in the loan. The fair value of loans held for sale is determined by reference to quoted prices for loans with similar coupon rates and terms.

The Company enters into rate-lock commitments it makes to customers with the intention to sell the loan in the secondary market. The derivatives arising from the rate-lock commitments are recorded at fair value in other assets and liabilities and changes in that fair value are included in other income. The fair value of the rate-lock commitment derivatives are determined by reference to quoted prices for loans with similar coupon rates and terms. Gains and losses on the sale of those loans are included in other income.

***Loans Held for Investment***

Loans held for investment are carried at the principal amount outstanding less any write-downs which may be necessary to reduce individual loans to net realizable value. Individually significant commercial loans are evaluated for impairment when evidence of impairment exists. Impairment allowances are recorded through specific additions to the allowance for loan losses. Loans are considered past due when principal or interest becomes delinquent by 30 days or more. Consumer loans are charged off when the loan becomes 120 days past due (180 days

**Table of Contents**

**FIRST COMMUNITY BANCSHARES, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

if secured by residential real estate). Other loans are charged off against the allowance for loan losses after collection attempts have been exhausted, which generally is within 120 days. Recoveries of loans charged off are credited to the allowance for loan losses in the period received.

***Allowance for Loan Losses***

The allowance for loan losses is maintained at levels management deems adequate to absorb probable losses inherent in the portfolio, and is based on management's evaluation of the risks in the loan portfolio and changes in the nature and volume of loan activity. The Company consistently applies a review process to periodically evaluate loans and commitments for changes in credit risk. This process serves as the primary means by which the Company evaluates the adequacy of the allowance for loan losses.

The Company determines the allowance for loan losses by making specific allocations to impaired loans that exhibit inherent weaknesses and various credit risk factors. General allocations to commercial, residential real estate, and consumer loan pools are developed giving weight to risk ratings, historical loss trends and management's judgment concerning those trends and other relevant factors. These factors may include, among others, actual versus estimated losses, regional and national economic conditions, business segment and portfolio concentrations, industry competition and consolidation, and the impact of government regulations. The foregoing analysis is performed by management to evaluate the portfolio and calculate an estimated valuation allowance through a quantitative and qualitative analysis that applies risk factors to those identified risk areas.

This risk management evaluation is applied at both the portfolio level and the individual loan level for commercial loans and credit relationships while the level of consumer and residential mortgage loan allowance is determined primarily on a total portfolio level based on a review of historical loss percentages and other qualitative factors including concentrations, industry specific factors and economic conditions. The commercial portfolio requires more specific analysis of individually significant loans and the borrower's underlying cash flow, business conditions, capacity for debt repayment and the valuation of secondary sources of payment, such as collateral. This analysis may result in specifically identified weaknesses and corresponding specific impairment allowances. While allocations are made to specific loans and classifications within the various categories of loans, the allowance for loan losses is available for all loan losses.

The use of various estimates and judgments in the Company's ongoing evaluation of the required level of allowance can significantly impact the Company's results of operations and financial condition and may result in either greater provisions against earnings to increase the allowance or reduced provisions based upon management's current view of portfolio and economic conditions and the application of revised estimates and assumptions. Differences between actual loan loss experience and estimates are reflected through adjustments either increasing or decreasing the loan loss provision based upon current measurement criteria.

***Long-term Investments***

Certain long-term equity investments representing less than 20% ownership are accounted for under the cost method, are carried at cost, and are included in other assets. These investments in operating companies represent required long-term investments in insurance, investment and service company affiliates or consortiums which serve as vehicles for the delivery of various support services. In accordance with the cost method, dividends received are recorded as

current period revenues and there is no recognition of the Company's proportionate share of net operating income or loss. The Company has determined that fair value measurement is not practical, and further, nothing has come to the attention of the Company that would indicate impairment of any of these investments.

As a condition to membership in the FHLB system, the Bank is required to subscribe to a minimum level of stock in the FHLB. At December 31, 2008 and 2007, the Bank owned approximately \$13.17 million and \$16.89 million in FHLB stock, respectively, which is classified as other assets. Because of the redemption

**Table of Contents**

**FIRST COMMUNITY BANCSHARES, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

provisions of the FHLB stock, the Company estimates that fair value approximates cost resulting in no impairment at December 31, 2008 or 2007.

***Premises and Equipment***

Premises and equipment are stated at cost less accumulated depreciation. Depreciation and amortization are computed on the straight-line method over estimated useful lives. Useful lives range from 5 to 10 years for furniture, fixtures, and equipment; three to five years for software, hardware, and data handling equipment; and 10 to 40 years for buildings and building improvements. Land improvements are amortized over a period of 20 years, and leasehold improvements are amortized over the lesser of the useful life or the term of the lease plus the first optional renewal period, when renewal is reasonably assured. Maintenance and repairs are charged to current operations while improvements that extend the economic useful life of the underlying asset are capitalized. Disposition gains and losses are reflected in current operations.

The Company leases various properties within its branch network. Leases generally have initial terms of up to 20 years and most contain options to renew with reasonable increases in rent. All leases are accounted for as operating leases.

***Other Real Estate Owned***

Other real estate owned and acquired through foreclosure is stated at the lower of cost or fair value less estimated costs to sell. Loan losses arising from the acquisition of such properties are charged against the allowance for loan losses. Expenses incurred in connection with operating the properties, subsequent write-downs and gains or losses upon sale are included in other noninterest expense.

***Goodwill and Other Intangible Assets***

The excess of the cost of an acquired company over the fair value of the net assets and identified intangibles acquired is recorded as goodwill. The net carrying amount of goodwill was \$83.19 million and \$66.31 million at December 31, 2008 and 2007, respectively. A portion of the purchase price in certain transactions has been allocated to values associated with the future earnings potential of acquired deposits and is being amortized over the estimated lives of the deposits, ranging from four to ten years while the weighted average remaining life of these core deposits is approximately 8.0 years. As of December 31, 2008 and 2007, the balance of core deposit intangibles was \$6.41 million and \$4.59 million, respectively, while the corresponding accumulated amortization was \$3.79 million and \$3.41 million, respectively. The net unamortized balance of identified intangibles associated with acquired deposits was \$3.02 million and \$1.18 million at December 31, 2008 and 2007, respectively. The acquisition of Greenpoint, and its continued acquisitions, added \$1.35 million of goodwill and \$1.14 million in other identified intangible assets for the period ended December 31, 2008. The acquisition of Investment Planning Consultants, Inc. added a total of \$240 thousand of goodwill for the period ended December 31, 2008. Annual amortization expense of all intangibles for 2009 and the succeeding four years are approximately \$962 thousand, \$869 thousand, \$864 thousand, \$672 thousand, and \$598 thousand, respectively.

The Company reviews and tests goodwill for potential impairment on an annual basis in November. Goodwill is tested for impairment by comparing the fair value of the unit with its book value, including goodwill. If the fair value of the

Company is greater than its book value, no goodwill impairment exists. However, if the book value of the Company is greater than its determined fair value, goodwill impairment may exist and further testing is required to determine the amount, if any, of the actual impairment loss.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

The progression of the Company's goodwill and intangible assets for continuing operations for the three years ended December 31, 2008, is detailed in the following table:

	<b>Goodwill</b>	<b>Other Intangibles</b>
	<b>(Amounts in thousands)</b>	
Balance at December 31, 2005	\$ 59,182	\$ 1,937
Acquisitions and dispositions, net	953	472
Amortization		(348)
Balance at December 31, 2006	60,135	2,061
Acquisitions	6,175	2,152
Amortization		(467)
Balance at December 31, 2007	66,310	3,746
Acquisitions	15,990	3,362
Other Adjustments	892	
Amortization		(689)
Balance at December 31, 2008	\$ 83,192	\$ 6,419

***Other Assets***

In addition to deferred tax assets, other assets included \$40.78 million and \$37.20 million in cash surrender value of life insurance and \$13.17 million and \$16.89 million in FHLB stock at December 31, 2008 and 2007, respectively.

In connection with the bank-owned life insurance, the Company has also entered into Life Insurance Endorsement Method Split Dollar Agreements with certain of the individuals whose lives are insured. Under Split Dollar Agreements, the Company shares 80% of death benefits (after recovery of cash surrender value) with the designated beneficiaries of the plan participants under life insurance contracts. The Company as owner of the policies retains a 20% interest in life proceeds and a 100% interest in the cash surrender value of the policies. 2008 expenses associated with split dollar agreements were \$126 thousand.

***Securities Sold Under Agreements to Repurchase***

Securities sold under agreements to repurchase are generally accounted for as collateralized financing transactions. Securities, generally U.S. government and Federal agency securities, pledged as collateral under these arrangements cannot be sold or repledged by the secured party. The fair value of the collateral provided to a third party is continually monitored, and additional collateral is provided as appropriate.

***Loan Interest Income Recognition***



Accrual of interest on loans is based generally on the daily amount of principal outstanding. Loans are considered past due when either principal or interest payments are delinquent by 30 or more days. It is the Company's policy to discontinue the accrual of interest on loans based on the payment status and evaluation of the related collateral and the financial strength of the borrower. The accrual of interest income is normally discontinued when a loan becomes 90 days past due as to principal or interest. Management may elect to continue the accrual of interest when the loan is well secured and in process of collection. When interest accruals are discontinued, interest accrued and not collected in the current year is reversed from income and interest accrued and not collected from prior years is charged to the allowance for loan losses. Interest income realized on impaired loans is recognized upon receipt if the impaired loan is on a non-accrual basis. Accrual of interest on non-accrual loans may be resumed if the loan is brought current and follows a period of substantial performance, including six months of regular

**Table of Contents**

**FIRST COMMUNITY BANCSHARES, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

principal and interest payments. Accrual of interest on impaired loans is generally continued unless the loan becomes delinquent 90 days or more.

***Loan Fee Income***

Loan origination and underwriting fees are reduced by direct and indirect costs associated with loan processing, including salaries, review of legal documents and obtainment of appraisals. Net origination fees and costs are deferred and amortized over the life of the related loan. Loan commitment fees are deferred and amortized over the related commitment period. Net deferred loan fees were \$447 thousand at December 31, 2008, and net deferred costs were \$574 thousand at December 31, 2007.

***Advertising Expenses***

Advertising costs are generally expensed as incurred. Amounts recognized for the three years ended December 31, 2008, are detailed in Note 16 Other Operating Expenses.

***Equity-Based Compensation***

The cost of employee services received in exchange for equity instruments including options and restricted stock awards generally are measured at fair value at the grant date. The effect of option shares on earnings per share relates to the dilutive effect of the underlying options outstanding. To the extent the granted exercise share price is less than the current market price, or in the money, there is an economic incentive for the options to be exercised and an increase in the dilutive effect on earnings per share.

***Income Taxes***

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, income on bank-owned life insurance, and tax credits generated by investments in low income housing and rehabilitation of historic structures.

The Company adopted FIN 48 on January 1, 2007. The adoption of FIN 48 had no material impact on financial position or results of operations. 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.

During 2005 and 2006, the Company invested in limited partnerships formed to perform the rehabilitation of properties certified as historic structures by the National Park Service. The Company's investment in these partnerships generates federal and state historic tax credits. The associated credits are realized and the balance of the investment is written off at the time the buildings are placed in service. As of December 31, 2008, all buildings associated with the partnership investments were in service.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)*****Earnings Per Share***

Basic earnings per share is determined by dividing net income available to common shareholders by the weighted average number of shares outstanding. Diluted earnings per share is determined by dividing net income available to common shareholders by the weighted average shares outstanding increased by the dilutive effect of stock options. Basic and diluted net income per common share calculations follow:

	<b>For the Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands, except share and per share data)</b>		
Net income available to common shareholders	\$ 2,826	\$ 29,632	\$ 28,948
Weighted average shares outstanding	11,058,076	11,204,676	11,204,875
Dilutive shares for stock options	53,680	65,320	74,605
Contingently issuable shares	22,269	22,875	
Common stock warrants			
Weighted average dilutive shares outstanding	11,134,025	11,292,871	11,279,480
Basic earnings per share	\$ 0.26	\$ 2.64	\$ 2.58
Diluted earnings per share	\$ 0.25	\$ 2.62	\$ 2.57

***Variable Interest Entities***

The Company maintains ownership positions in various entities which it deems variable interest entities ( VIE s ) as defined in FIN 46R. These VIE s include certain tax credit limited partnerships and other limited liability companies which provide aviation services, insurance brokerage, investment brokerage, title insurance and other financial and related services. Based on the Company s analysis, it is a non-primary beneficiary; accordingly, these entities do not meet the criteria for consolidation under FIN 46R. The carrying value of VIE s was \$1.50 million and \$1.89 million at December 31, 2008 and 2007, respectively. The Company s maximum possible loss exposure was \$1.51 million and \$1.93 million at December 31, 2008 and 2007, respectively. Management does not believe losses resulting from its involvement with the entities discussed above will be material.

***Derivative Instruments***

The Company enters into derivative transactions principally to protect against the risk of adverse price or interest rate movements on the value of certain assets and liabilities and on future cash flows. In addition, certain contracts and commitments are defined as derivatives under generally accepted accounting principles.

Under the requirements of SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended, all derivative instruments are carried at fair value on the balance sheet. SFAS 133 provides special hedge accounting provisions, which permit the change in the fair value of the hedged item related to the risk being hedged to be recognized in earnings in the same period and in the same income statement line as the change in the fair value of the derivative.

Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges under SFAS 133. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking each hedge transaction.

**Table of Contents**

**FIRST COMMUNITY BANCSHARES, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

***Other Recent Accounting Developments***

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. The Company adopted SFAS 141R effective January 1, 2009.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS 158 requires an employer to: (a) recognize in its statement of financial position an asset for a plan 's overfunded status or a liability for a plan 's underfunded status; (b) measure a plan 's assets and its obligations that determine its funded status as of the end of the employer 's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer 's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008.

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.

The Company adopted Financial Accounting Standards Board Staff Position EITF Issue No 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20. This FSP was finalized in January 2009 and applied to years ended after December 15, 2008. This standard amended the impairment guidance in EITF 99-20 to that of FASB Statement No. 115 by removing the requirement of management to consider a

**Table of Contents**

**FIRST COMMUNITY BANCSHARES, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

market participant's assumptions about cash flows in assessing whether or not an adverse change in previously anticipated cash flows has occurred. The adoption impacted the analysis performed by the Company to determine other than temporary impairment for certain collateralized debt obligations.

**Note 2. Merger, Acquisitions and Branching Activity**

On November 14, 2008, the Company completed the acquisition of Coddle Creek Financial Corp ( Coddle Creek ), based in Mooresville, North Carolina. Coddle Creek had three full service locations in Mooresville, Cornelius, and Huntersville, North Carolina. At acquisition, Coddle Creek had total assets of approximately \$158.66 million, loans of approximately \$136.99 million, and deposits of approximately \$137.06 million. Under the terms of the merger agreement, shares of Coddle Creek were exchanged for .9046 shares of the Company's common stock and \$19.60 in cash, for a total purchase price of approximately \$32.29 million. As a result of the acquisition and preliminary purchase price allocation, approximately \$14.41 million in goodwill was recorded, which represents the excess purchase price over the fair market value of the net assets acquired and identified intangibles. Because the results of operations of Coddle Creek are not significant, pro forma information is not being provided.

In September 2007, the Company completed the acquisition of GreenPoint Insurance Group, Inc. ( GreenPoint ), an insurance agency located in High Point, North Carolina. 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, portions of 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 also assumed \$5.57 million in debt in connection with the acquisition, of which approximately \$5.00 million was paid off at closing. Through December 31, 2008, the Company issued 7,728 shares of Common Stock as additional consideration adding approximately \$267 thousand to goodwill.

Throughout 2008, GreenPoint acquired a total of five agencies. The two largest were Carr & Hyde in Warrenton, Virginia, and REL in Greensboro, North Carolina. GreenPoint issued cash consideration of approximately \$2.04 million through 2008 in connection with the acquisitions. Acquisition terms in all instances call for issuing further cash consideration if certain operating performance targets are met. If those targets are met, the value of the consideration ultimately paid will be added to the cost of the acquisitions. GreenPoint's 2008 acquisitions added approximately \$2.04 million of goodwill and intangibles to the Company's balance sheet.

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

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



amount of goodwill arising in the acquisition. Through December 31, 2008, the Company issued 21,762 shares of Common Stock as additional consideration adding approximately \$695 thousand to goodwill.

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

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

The following table summarizes the net cash provided by or used in acquisitions and divestitures during the three years ended December 31, 2008.

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands)</b>		
Fair value of investments acquired	\$ 1,269	\$	\$
Fair value of loans acquired	136,035		
Fair value of premises and equipment acquired	4,505		
Fair value of other assets	23,872	382	232
Fair value of deposits assumed	(137,606)		
Fair value of other liabilities assumed	(4,967)	(1,167)	(17)
Purchase price in excess of net assets acquired	15,991	7,838	1,488
Total purchase price	39,099	7,053	1,703
Less non-cash purchase price	19,647	1,658	1,465
Less cash acquired	14,792	32	18
Net cash paid for acquisition	\$ 4,660	\$ 5,363	\$ 220
Book value of assets sold	\$	\$	\$ (4,678)
Book value of liabilities sold			27,164
Sales price in excess of net liabilities assumed			(1,035)
Total sales price			21,451
Add cash on hand sold			395
Less amount due remaining on books			20
Net cash paid for divestiture	\$	\$	\$ 21,826

**Note 3. Participation in U.S. Treasury Capital Purchase Program**

On November 21, 2008, the Company entered into a Letter Agreement, which incorporates by reference the Securities Purchase Agreement Standard Terms (the Purchase Agreement), with the U.S. Department of the Treasury ( Treasury ). Pursuant to the terms of the Purchase Agreement, the Company issued and sold to the Treasury (i) 41,500 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock) and (ii) a warrant (the Warrant) to purchase 176,546 shares of the Company's common stock, par value \$1.00 per share (the Common Stock), for an aggregate purchase price of \$41.50 million in cash.

The Series A Preferred Stock qualifies as Tier 1 capital and will pay cumulative dividends at a rate of 5.00% per annum for the first five years, and 9.00% per annum thereafter. The Series A Preferred Stock is generally non-voting. The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an initial per share exercise

price of \$35.26. Pursuant to the Purchase Agreement, Treasury has agreed not to exercise voting power with respect to any share of Common Stock issued upon exercise of the Warrant.

The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. In accordance with the terms of the Purchase Agreement, the Company registered the Series A Preferred Stock, the Warrant, and the shares of Common Stock underlying the Warrant with the Securities and Exchange Commission (the SEC). Neither the Series A Preferred Stock nor the Warrant are subject to any contractual restrictions on transfer, except that Treasury may only transfer or exercise one-half of the Warrant shares prior to the earlier of the redemption of 100% of the Series A Preferred Stock and December 31, 2009.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

Pursuant to the terms of the Purchase Agreement, upon issuance of the Series A Preferred Stock, the ability of the Company to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Common Stock is subject to restrictions, including a restriction against increasing cash dividends above the amount of the last quarter cash dividend per share declared prior to October 14, 2008, which was \$0.28 per share, without express permission of the Treasury. These restrictions will terminate on the earlier of (a) the third anniversary date of the Series A Preferred Stock and (b) the date on which the Series A Preferred Stock has been redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock to third parties.

Based on a Black-Scholes-Merton options pricing model, the Warrant has been assigned a fair value of \$4.44 per underlying share, or \$784 thousand in the aggregate, as of November 21, 2008. As a result, \$1.10 million was recorded as the discount on the preferred stock obtained above and will be accreted as a reduction in net income available for common shareholders over the next five years at approximately \$215 thousand to \$219 thousand per year. For purposes of these calculations, the fair value of the Warrant as of November 21, 2008, was estimated using the Black-Scholes-Merton option pricing model and the following assumptions:

Risk free interest rate	3.20%
Expected life	10 years
Expected dividend yield	4.17%
Expected volatility	29.11%
Weighted average fair value	\$4.44

At issuance, a value of \$40.40 million was assigned to the Series A Preferred Stock and will be accreted up to the redemption amount of \$41.50 million at November 21, 2013.

**Note 4. Investment Securities**

The amortized cost and estimated fair value of securities, with gross unrealized gains and losses, classified as available-for-sale are as follows:

	Amortized Cost	December 31, 2008		Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. Government agency securities	\$ 53,425	\$ 1,393	\$	\$ 54,818
States and political subdivisions	163,042	864	(4,487)	159,419
Trust-preferred securities	148,760		(82,707)	66,053
Mortgage-backed securities	230,488	4,649	(1,659)	233,478
Equities	7,979	357	(1,381)	6,955
Total	\$ 603,694	\$ 7,263	\$ (90,234)	\$ 520,723

		<b>December 31, 2007</b>		
	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
		<b>(Amounts in thousands)</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
Total	\$ 674,937	\$ 6,743	\$ (17,560)	\$ 664,120

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

The amortized cost and estimated fair value of available-for-sale securities by contractual maturity, at December 31, 2008, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Available For Sale	U.S. Government Agencies & Corporations	States and Political Subdivisions	Corporate Notes	Total	Tax Equivalent Purchase Yield
	(Dollars in thousands)				
Amortized Cost Maturity:					
Within one year	\$	\$ 940	\$	\$ 940	6.01%
After one year through five years		5,403		5,403	6.63%
After five years through ten years		84,036		84,036	6.01%
After ten years	53,425	72,663	148,760	274,848	4.25%
Amortized cost	\$ 53,425	\$ 163,042	\$ 148,760	365,227	
Mortgage-backed securities				230,488	5.13%
Equity securities				7,979	3.68%
Total Amortized cost				\$ 603,694	
Tax equivalent purchase yield	5.82%	6.29%	2.55%	4.70%	
Average contractual maturity (in years)	12.75	10.45	24.52	16.52	
Fair Value Maturity:					
Within one year	\$	\$ 945	\$	\$ 945	
After one year through five years		5,447		5,447	
After five years through ten years		83,278		83,278	
After ten years	54,818	69,749	66,053	190,620	
Fair Value	\$ 54,818	\$ 159,419	\$ 66,053	280,290	
Mortgage-backed securities				233,478	
Equity securities				6,955	
Total Fair Value				\$ 520,723	

The amortized cost and estimated fair value of securities, with gross unrealized gains and losses, classified as held-to-maturity are as follows:

	<b>Amortized Cost</b>	<b>December 31, 2008</b>		<b>Fair Value</b>
		<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
		<b>(Amounts in thousands)</b>		
States and political subdivisions	\$ 8,670	\$ 133	\$ (1)	\$ 8,802
Total	\$ 8,670	\$ 133	\$ (1)	\$ 8,802

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

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

The amortized cost and estimated fair value of securities by contractual maturity, at December 31, 2008, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

<b>Held-to-Maturity</b>	<b>States and Political Subdivisions</b>	<b>Tax Equivalent Purchase Yield</b>
	<b>(Dollars in thousands)</b>	
Amortized Cost Maturity:		
Within one year	\$ 450	7.94%
After one year through five years	4,570	7.85%
After five years through ten years	3,650	8.13%
After ten years		
Total amortized cost	\$ 8,670	
Tax equivalent purchase yield		7.97%
Average contractual maturity (in years)		4.24
Fair Value Maturity:		
Within one year	\$ 452	
After one year through five years	4,629	
After five years through ten years	3,721	
After ten years		
Total fair value	\$ 8,802	



The carrying value of securities pledged to secure public deposits and for other purposes required by law were \$377.56 million and \$426.41 million at December 31, 2008 and 2007, respectively.

In 2008, net gains on the sale of securities were \$1.90 million. Gross gains were \$2.84 million while gross losses were \$938 thousand. In 2007, net gains on the sale of securities were \$411 thousand. Gross gains were \$540 thousand while gross losses were \$128 thousand.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

The following tables reflect those investments, both available-for-sale and held-to-maturity, in a continuous unrealized loss position for less than 12 months and for 12 months or longer for the years ended December 31, 2008 and 2007. There were no securities for either period in a continuous unrealized loss position for 12 or more months for which the Company does not have the ability to hold until the security matures or recovers in value.

Description of Securities	Less than 12 Months		December 31, 2008 12 Months or Longer		Total		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
			(Amounts in thousands)				
U. S. Government agency securities	\$	\$	\$	\$	\$	\$	
States and political subdivisions	86,344	(2,949)	16,413	(1,539)	102,757	(4,488)	
Trust-preferred securities			60,260	(82,707)	60,260	(82,707)	
Mortgage-backed securities	48,440	(1,658)	43	(1)	48,483	(1,659)	
Equity securities	2,167	(1,161)	2,201	(220)	4,368	(1,381)	
Total	\$ 136,951	\$ (5,768)	\$ 78,917	\$ (84,467)	\$ 215,868	\$ (90,235)	

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	
			(Amounts in thousands)				
U. S. Government agency securities	\$	\$	\$ 1,999	\$	\$ 1,999	\$	
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)	
Total	\$ 179,727	\$ (13,784)	\$ 101,432	\$ (3,776)	\$ 281,159	\$ (17,560)	

As of December 31, 2008, the Company recognized a non-cash impairment charge of \$14.47 million which stems from a 2006 vintage collateralized mortgage obligation. The Company's analysis of the bond showed probable losses of \$1.69 million, or 6.76%, of the \$25.00 million par value of the security. Additionally, one of the Company's pooled trust preferred securities showed an adverse change in cash flow, resulting in a pre-tax other-than-temporary impairment charge of \$15.46 million. Total pre-tax, non-cash impairment charges of \$29.92 million are reflected in

non-interest income.

Included in available-for-sale securities is a portfolio of trust-preferred securities with a total market value of approximately \$66.05 million as of December 31, 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 \$33.54 million as of December 31, 2008, compared with their adjusted cost basis of approximately \$55.49 million.

At December 31, 2008, the total market value of the pooled trust-preferred securities was approximately \$32.51 million, compared with an adjusted cost basis of approximately \$93.27 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. The securities carry variable rate structures that float at a prescribed margin over 3-month LIBOR. During 2008, certain of these experienced a credit rating downgrade from one rating agency, and certain of these securities are on negative watch by one or more rating firms. The Company has modeled the expected cash flows from the pooled trust-preferred securities and, at present, does not expect any of the remaining securities to have an adverse cash flow effect under any of the scenarios modeled due to the existence of other subordinate classes within the pools.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

At December 31, 2008, the combined depreciation in value of the 310 individual securities in an unrealized loss position was approximately 17.04% of the combined reported value of the aggregate securities portfolio. At December 31, 2007, the combined depreciation in value of the 159 individual securities in an unrealized loss position was approximately 2.69% of the combined reported value of the aggregate securities portfolio. Management does not believe any individual unrealized loss as of December 31, 2008, represents other-than-temporary impairment. The Company has the ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes that portions of the change in value are attributable to changes in market interest rates and the current state of illiquidity within the market for securitized assets.

**Note 5. Loans**

Loans held for investment, net of unearned income, consist of the following at December 31:

	<b>2008</b>	<b>2007</b>
	<b>(Amounts in thousands)</b>	
Real estate-commercial	\$ 407,638	\$ 386,112
Real estate-construction	130,610	163,310
Real estate-residential	602,573	498,345
Commercial, financial and agricultural	85,034	96,261
Loans to individuals for household and other consumer expenditures	66,258	75,447
All other loans	6,046	6,027
<b>Total loans</b>	<b>\$ 1,298,159</b>	<b>\$ 1,225,502</b>

In the normal course of business, the Company's subsidiary bank has made loans to directors and executive officers of the Company and its subsidiaries. All loans and commitments made to such officers and directors and to companies in which they are officers, or have significant ownership interest, have been made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. The aggregate dollar amount of such loans was \$5.98 million and \$5.05 million at December 31, 2008 and 2007, respectively. During 2008, approximately \$4.30 million in new loans and increases were made and repayments on such loans to officers and directors totaled \$3.38 million. There were no changes due to changes in composition of the Company's board members and executive officers.

At December 31, 2008 and 2007, customer overdrafts totaling \$2.10 million and \$3.23 million, respectively, were reclassified as loans.

**Note 6. Allowance for Loan Losses**

Activity in the allowance for loan losses was as follows:

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands)</b>		
Balance at January 1	\$ 12,833	\$ 14,549	\$ 14,736
Provision for loan losses	7,422	717	2,706
Acquisition balance	1,169		
Loans charged off	(7,371)	(4,295)	(4,543)
Recoveries credited to allowance	1,925	1,862	1,650
Net charge-offs	(5,446)	(2,433)	(2,893)
Balance at December 31	\$ 15,978	\$ 12,833	\$ 14,549

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

Management analyzes the loan portfolio regularly for concentrations of credit risk, including concentrations in specific industries and geographic location. At December 31, 2008, commercial real estate loans comprised 31.40% of the total loan portfolio. Commercial loans include loans to small to mid-size industrial, commercial and service companies that include but are not limited to coal mining companies, manufacturers, automobile dealers, and retail and wholesale merchants. Commercial real estate projects represent several different sectors of the commercial real estate market, including residential land development, single family and apartment building operators, commercial real estate lessors, and hotel/motel developers. Underwriting standards require that comprehensive reviews and independent evaluations be performed on credits exceeding predefined market limits on commercial loans. Updates to these loan reviews are done periodically or on an annual basis depending on the size of the loan relationship.

The majority of the loans in the current portfolio were made and collateralized in Virginia, West Virginia, North Carolina, Tennessee and the surrounding region. Although sections of the West Virginia and Southwestern Virginia economies are closely related to natural resources, they are supplemented by service industries. The Company's presence in five states, Virginia, West Virginia, North Carolina, South Carolina, and Tennessee, provides additional diversification against geographic concentrations of credit risk.

The following table presents the Company's investment in loans considered to be impaired and related information on those impaired loans:

	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands)</b>		
Recorded investment in loans considered to be impaired	\$ 13,300	\$ 4,325	\$ 5,786
Loans considered to be impaired that were on a non-accrual basis	12,764	2,923	3,813
Recorded investment in impaired loans with related allowance	4,795	3,129	4,070
Allowance for loan losses related to loans considered to be impaired	678	880	1,531
Average recorded investment in impaired loans	14,914	4,762	6,410
Total interest income recognized on impaired loans	793	237	390
Recorded investment in impaired loans with no related allowance	8,505	1,196	1,716

There were no loans past due 90 days and still accruing interest at December 31, 2008, 2007, and 2006.

**Note 7. Premises and Equipment**

Premises and equipment are comprised of the following as of December 31:

	<b>2008</b>	<b>2007</b>
	<b>(Amounts in thousands)</b>	
Land	\$ 18,634	\$ 14,841
Bank premises	47,147	42,608
Equipment	29,968	28,087

	95,749	85,536
Less: accumulated depreciation and amortization	40,725	37,153
Total	\$ 55,024	\$ 48,383

Total depreciation and amortization expense for three years ended December 31, 2008, was \$3.88 million, \$3.28 million, and \$3.37 million, respectively.

The Company began construction on seven branches over the last two years. The primary contractor for construction of two of those branches is a firm which has a preferred shareholder who is an immediate family member of two directors of the Company. All branch construction contracts involving the related party were let

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

pursuant to a competitive bidding process. Total payments to the related party were \$606 thousand and \$703 thousand for 2008 and 2007, respectively. There were no payments to the related party in 2006.

The Company also enters into land and building leases for the operation of banking and loan production offices, operations centers and for the operation of automated teller machines. All such leases qualify as operating leases. Following is a schedule by year of future minimum lease payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2008:

**Year Ended December 31:**

	<b>(Amounts in thousands)</b>
2009	\$ 762
2010	596
2011	432
2012	346
2013	280
Later years	183
Total	\$ 2,599

Total lease expense for the three years ended December 31, 2008, was \$1.01 million, \$981 thousand, and \$1.02 million, respectively. Certain portions of the above listed leases have been sublet to third parties for properties not currently being used by the Company. The impact of the future lease payments to be received and the non-cancelable subleases are as follows:

**Year Ended December 31:**

	<b>(Amounts in thousands)</b>
2009	\$ 172
2010	157
2011	123
2012	54
2013	50
Later years	274
Total	\$ 830

**Note 8. Deposits**



The following is a summary of interest-bearing deposits by type as of December 31:

	<b>2008</b>	<b>2007</b>
	<b>(Amounts in thousands)</b>	
Interest-bearing demand deposits	\$ 185,117	\$ 153,570
Money market accounts	144,017	167,296
Savings deposits	165,560	160,395
Certificates of deposit	708,954	608,470
Individual Retirement Accounts	100,398	79,625
<b>Total</b>	<b>\$ 1,304,046</b>	<b>\$ 1,169,356</b>

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

At December 31, 2008, the scheduled maturities of certificates of deposit are as follows:

	<b>(Amounts in thousands)</b>
2009	\$ 515,742
2010	101,631
2011	63,822
2012	24,396
2013 and thereafter	103,761
	<b>\$ 809,352</b>

Time deposits of \$100 thousand or more were \$286.74 million and \$246.63 million at December 31, 2008 and 2007, respectively.

At December 31, 2008, the scheduled maturities of certificates of deposit of \$100 thousand or more are as follows:

	<b>(Amounts in thousands)</b>
Three months or less	\$ 56,644
Over three to six months	49,237
Over six to twelve months	98,565
Over twelve months	82,295
Total	<b>\$ 286,741</b>

Included in total deposits are deposits by related parties in the total amount of \$25.48 million and \$30.70 million at December 31, 2008 and 2007, respectively.

**Note 9. Borrowings**

The following table details borrowings as of December 31:

	<b>2008</b>	<b>2007</b>
	<b>(Amounts in thousands)</b>	
Federal funds purchased	\$	\$ 18,500

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Securities sold under agreements to repurchase	165,914	207,427
FHLB borrowings	200,000	275,888
Subordinated debt	15,464	15,464
Other debt	413	564
Total	\$ 381,791	\$ 517,843

Securities sold under agreements to repurchase include \$115.91 million and \$157.43 million of retail overnight and term repurchase agreements and \$50.00 million of wholesale repurchase agreements at December 31, 2008 and 2007, respectively.

The Bank is a member of the FHLB which provides credit in the form of short-term and long-term advances collateralized by various mortgage assets. At December 31, 2008, credit availability with the FHLB totaled approximately \$106.28 million. Advances from the FHLB are secured by stock in the FHLB of Atlanta, qualifying loans of \$301.98 million, mortgage-backed securities, and certain investment securities of \$42.58 million. The FHLB advances are subject to restrictions or penalties in the event of prepayment.

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)**

FHLB borrowings include \$200.00 million and \$275.00 million in convertible and callable advances at December 31, 2008 and 2007, respectively. The callable advances may be called, or 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 an adjustable rate advance. At December 31, 2007, the Company also held non-callable term advances of \$888 thousand. The weighted-average contractual rate of the FHLB advances was 3.70% at December 31, 2008.

At December 31, 2008, the FHLB advances have approximate contractual final maturities between nine and thirteen years. The scheduled maturities of the advances are as follows:

	<b>(Amounts in thousands)</b>
2009	\$
2010	
2011	
2012	
2013	
2014 and thereafter	200,000
	\$ 200,000

In January 2006, the Company entered into a derivative swap instrument where it receives LIBOR-based variable interest payments and pays fixed interest payments. The notional amount of the derivative swap is \$50.00 million and effectively fixes a portion of the FHLB borrowings at approximately 4.34%. After considering the effect of the interest rate swap, the effective weighted average interest rate of the FHLB borrowings was 3.70% and 4.30% at December 31, 2008 and 2007, respectively.

Also included in borrowings 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 currently callable. The net proceeds from the offering were contributed as capital to the Company's subsidiary bank to support further growth.

The Company has committed to irrevocably and unconditionally guarantee the following payments or distributions with respect to the trust 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.



**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****NOTES TO CONSOLIDATED STATEMENTS (Continued)****Note 10. Income Taxes, Continuing Operations**

The components of income tax benefit and expense from continuing operations consist of the following:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Amounts in thousands)</b>		
Current tax expense			
Federal	\$ 8,577	\$ 10,777	\$ 9,883
State	1,260	1,341	1,129
	9,837	12,118	11,012
Deferred tax (benefit) expense			
Federal	(11,350)	194	418
State	(1,297)	22	47