FIRST COMMUNITY BANCSHARES INC /NV/
Form 10-Q
August 09, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarter ended June 30, 2006
Commission file number 000-19297
FIRST COMMUNITY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Nevada	**55-0694814**
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
P.O. Box 989 **Bluefield, Virginia**	**24605-0989**
(Address of principal executive offices)	(Zip Code)

(276) 326-9000
(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.
Class Common Stock, $1.00 Par Value; 11,164,774 shares outstanding as of July 31, 2006

FIRST COMMUNITY BANCSHARES, INC.
FORM 10-Q
For the quarter ended June 30, 2006
INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets as of June 30, 2006 (Unaudited), and December 31, 2005	3
Consolidated Statements of Income for the Three- and Six-Month Periods Ended June 30, 2006 and 2005 (Unaudited)	4
Consolidated Statements of Cash Flows for the Six-Month Periods Ended June 30, 2006 and 2005 (Unaudited)	5
Consolidated Statements of Changes in Stockholders Equity for the Six Months Ended June 30, 2006 and 2005 (Unaudited)	6
Notes to Consolidated Financial Statements	7
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3. Quantitative and Qualitative Disclosures about Market Risk	28
Item 4. Controls and Procedures	30
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	31
Item 1A. Risk Factors	31
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	31
Item 3. Defaults Upon Senior Securities	31
Item 4. Submission of Matters to a Vote of Security Holders	31
Item 5. Other Information	31
Item 6. Exhibits	32
SIGNATURES	34
EXHIBIT INDEX	35

EX-31.1
EX-31.2
EX-32

Table of Contents

PART I.
ITEM 1. Financial Statements

FIRST COMMUNITY BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS

(Amounts in Thousands, Except Share Data)	**June 30, 2006 (Unaudited)**	**December 31, 2005 (Note 1)**
Assets		
Cash and due from banks	$ 43,620	$ 46,872
Interest-bearing balances with banks	29,714	10,667
Total cash and cash equivalents	73,334	57,539
Securities available for sale (amortized cost of $412,660 at June 30, 2006; $405,667 at December 31, 2005)	405,761	404,381
Securities held to maturity (fair value of $21,057 at June 30, 2006; $24,877 at December 31, 2005)	20,641	24,173
Loans held for sale	1,293	1,274
Loans held for investment, net of unearned income	1,318,943	1,331,039
Less allowance for loan losses	14,710	14,736
Net loans held for investment	1,304,233	1,316,303
Premises and equipment	35,888	34,993
Other real estate owned	910	1,400
Interest receivable	10,179	10,232
Goodwill and other intangible assets	60,883	61,119
Other assets	66,510	41,069
Total Assets	$ 1,979,632	$ 1,952,483
Liabilities		
Deposits:		
Noninterest-bearing	$ 253,664	$ 230,542
Interest-bearing	1,159,462	1,175,402
Total Deposits	1,413,126	1,405,944
Interest, taxes and other liabilities	14,938	16,153
Federal funds purchased		82,500
Securities sold under agreements to repurchase	149,507	124,154
FHLB borrowings and other indebtedness	204,158	129,231
Total Liabilities	1,781,729	1,757,982
Stockholders Equity		
Preferred stock, par value undesignated; 1,000,000 shares authorized; none issued		

Common stock, $1 par value; 25,000,000 shares authorized; 11,499,018 and 11,496,312 shares issued at June 30, 2006, and December 31, 2005, including 322,563 and 244,509 shares in treasury, respectively	11,499	11,496
Additional paid-in capital	108,602	108,573
Retained earnings	91,136	82,828
Treasury stock, at cost	(10,097)	(7,625)
Accumulated other comprehensive income	(3,237)	(771)
Total Stockholders Equity	197,903	194,501
Total Liabilities and Stockholders Equity	$ 1,979,632	$ 1,952,483

See Notes to Consolidated Financial Statements.

Table of Contents

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

(Amounts in Thousands Except Share and Per Share Data)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Interest Income				
Interest and fees on loans held for investment	$ 24,506	$ 22,192	$ 48,431	$ 42,920
Interest on securities-taxable	3,224	2,555	6,101	4,851
Interest on securities-nontaxable	1,816	1,865	3,642	3,814
Interest on deposits in banks	479	178	774	393
Total interest income	30,025	26,790	58,948	51,978
Interest Expense				
Interest on deposits	8,326	5,547	15,973	10,509
Interest on borrowings	3,526	2,721	6,737	5,194
Total interest expense	11,852	8,268	22,710	15,703
Net interest income	18,173	18,522	36,238	36,275
Provision for loan losses	811	1,073	1,219	1,764
Net interest income after provision for loan losses	17,362	17,449	35,019	34,511
Noninterest Income				
Wealth management income	732	793	1,415	1,482
Service charges on deposit accounts	2,655	2,623	5,072	4,771
Other service charges, commissions and fees	711	671	1,451	1,330
Gain (loss) on sale of securities	(94)	121	66	143
Other operating income	1,516	362	2,664	566
Total noninterest income	5,520	4,570	10,668	8,292
Noninterest Expense				
Salaries and employee benefits	6,782	7,452	14,683	14,770
Occupancy expense of bank premises	1,011	968	2,051	1,911
Furniture and equipment expense	858	813	1,708	1,597
Core deposit amortization	144	111	234	221
Other operating expense	3,793	3,957	7,245	7,298
Total noninterest expense	12,588	13,301	25,921	25,797
Income from continuing operations before income taxes	10,294	8,718	19,766	17,006
Income tax expense	3,002	2,494	5,630	4,731
Income from continuing operations	7,292	6,224	14,136	12,275
Loss from discontinued operations before income tax		(39)		(170)
Income tax benefit		(15)		(66)

Loss from discontinued operations				(24)				(104)
Net income	$	7,292	$	6,200	$	14,136	$	12,171
Basic earnings per common share	$	0.65	$	0.55	$	1.26	$	1.08
Diluted earnings per common share	$	0.65	$	0.55	$	1.25	$	1.07
Basic earnings per common share continuing operations	$	0.65	$	0.55	$	1.26	$	1.09
Diluted earnings per common share continuing operations	$	0.65	$	0.55	$	1.25	$	1.08
Dividends declared per common share	$	0.26	$	0.255	$	0.52	$	0.51
Weighted average basic shares outstanding		11,201,052		11,273,724		11,216,940		11,266,648
Weighted average diluted shares outstanding		11,258,581		11,344,480		11,277,032		11,341,847

See Notes to Consolidated Financial Statements.

Table of Contents

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

	Six Months Ended June 30,	
(Amounts in thousands)	**2006**	**2005**
Operating activities continuing operations:		
Income from continuing operations	$ 14,136	$ 12,275
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Provision for loan losses	1,219	1,764
Depreciation and amortization of premises and equipment	1,709	1,628
Core deposit amortization	234	221
Net investment amortization and accretion	303	781
Net (gain) loss on the sale of assets	(785)	14
Mortgage loans originated for sale	(13,332)	(15,956)
Proceeds from sales of mortgage loans	13,372	16,138
Gain on sales of loans	(59)	(63)
Deferred income tax expense (benefit)	60	(379)
Decrease (increase) in interest receivable	43	(922)
Excess tax benefit from stock-based compensation	(105)	
Decrease (increase) in other assets	2,508	(4,082)
(Decrease) increase in other liabilities	(1,206)	600
Net cash provided by operating activities continuing operations	18,097	12,019
Investing activities continuing operations:		
Proceeds from sales of securities available for sale	1,824	16,707
Proceeds from maturities and calls of securities available for sale	12,807	24,410
Proceeds from maturities and calls of securities held to maturity	3,574	4,377
Purchase of securities available for sale	(20,379)	(35,218)
Purchase of bank-owned life insurance	(25,000)	
Net decrease (increase) in loans held for investment	9,514	(59,276)
Net cash used in branch divestiture	(13,721)	
Purchase of premises and equipment	(3,237)	(1,577)
Proceeds from sale of equipment	298	760
Net cash used in investing activities continuing operations	(34,320)	(49,817)
Financing activities continuing operations:		
Net increase (decrease) in demand and savings deposits	13,344	(21,242)
Net increase in time deposits	10,141	60,077
Net decrease in federal funds purchased	(82,500)	(32,500)
Net increase in securities sold under agreement to repurchase	25,632	15,428
Net proceeds from and repayments of FHLB and other borrowings	74,927	74,912
Proceeds from the exercise of stock options	322	255
Excess tax benefit from stock-based compensation	105	

Acquisition of treasury stock	(4,125)	(125)
Dividends paid	(5,828)	(5,746)
Net cash provided by financing activities continuing operations	32,018	91,059
Cash flows of discontinued operations: (Revised See Note 2)		
Net cash used in operating activities		(104)
Net cash used in investing activities		
Net cash used in financing activities		
Net cash used in discontinued operations		(104)
Increase in cash and cash equivalents	15,795	53,157
Cash and cash equivalents at beginning of period	57,539	54,746
Cash and cash equivalents at end of period	$ 73,334	$ 107,903
Supplemental information Noncash items		
Transfer of loans to other real estate	$ 490	$ 196

See Notes to Consolidated Financial Statements.

Table of Contents

FIRST COMMUNITY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Amounts in Thousands, Except Share and Per Share Information) (Unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive (Loss) Income	Total
Balance January 1, 2005	$ 11,472	$ 108,263	$ 68,019	$ (6,881)	$ 2,360	$ 183,233
Comprehensive income:						
Net income			12,171			12,171
Other comprehensive income, net of tax:						
Unrealized loss on securities available for sale					(276)	(276)
Less reclassification adjustment for gains realized in net income					(78)	(78)
Comprehensive income			12,171		(354)	11,817
Common dividends declared			(5,746)			(5,746)
Acquisition of 4,426 treasury shares				(125)		(125)
Acquisition of Stone Capital 2,447 shares issued	2	85				87
Stock awards 1,500 shares issued	2	18				20
Tax benefit from exercise stock options		180				180
Option exercise 23,876 shares	20	93		142		255
Balance June 30, 2005	$ 11,496	$ 108,639	$ 74,444	$ (6,864)	$ 2,006	$ 189,721
Balance January 1, 2006	$ 11,496	$ 108,573	$ 82,828	$ (7,625)	$ (771)	$ 194,501
Comprehensive income:						
Net income			14,136			14,136
Other comprehensive income, net of tax:						
Unrealized loss on securities available for sale					(3,352)	(3,352)
					(16)	(16)

Less reclassification adjustment for gains realized in net income						
Unrealized gain on derivative securities					902	902
Comprehensive income			14,136		(2,466)	11,670
Common dividends declared			(5,828)			(5,828)
Acquisition of 130,861 treasury shares				(4,125)		(4,125)
Acquisition of Stone Capital 2,706 shares issued	3	85				88
Stock awards 5,132 shares		(36)		160		124
ESOP allocation 27,733 shares		16		867		883
Equity-based compensation expense		140				140
Tax benefit from exercise stock options		139				139
Option exercises 19,942 shares		(315)		626		311
Balance June 30, 2006	$ 11,499	$ 108,602	$ 91,136	$ (10,097)	$ (3,237)	$ 197,903

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. General

Unaudited Consolidated Financial Statements

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

The consolidated balance sheet as of December 31, 2005, has been derived from the audited financial statements included in the Company s 2005 Annual Report on Form 10-K. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted in accordance with standards for the preparation of interim consolidated financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the 2005 Annual Report of First Community on Form 10-K.

A more complete and detailed description of First Community s significant accounting policies is included within Footnote 1 to the Company s Annual Report on Form 10-K for December 31, 2005. Further discussion of the Company s application of critical accounting policies is included within the Application of Critical Accounting Policies section of Part I, Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, included herein.

The Company operates within one business segment, community banking.

The cash flows resulting from discontinued operations have been revised to conform to the current year s presentation, which details cash flows from operating, investing, and financing activities.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48), an interpretation of Statement No. 109 Accounting for Income Taxes. FIN 48 provides guidance for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. FIN 48 also requires additional disclosures related to an entity s accounting for uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of FIN 48 on its consolidated financial statements, and is not yet in a position to determine the impact of the interpretation.

In March 2006, the FASB issued Statement No. 156, Accounting for Servicing of Financial Assets, which amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The Statement permits an entity to measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the change occurs. The Statement is effective as of an entity s first fiscal year beginning after September 15, 2006. However, earlier adoption of the Statement is permitted as of the beginning of an entity s fiscal year, provided the entity has not yet issued financial statements for any interim period of that fiscal year. The adoption of this standard is not expected to have a material impact on the Company s financial condition, the results of operations, or liquidity.

In February 2006, the FASB issued Statement No. 155, Accounting for Certain Hybrid Financial Instruments An Amendment of FASB Statements No. 133 and 140. This Statement amends FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, to require evaluation of all interests in securitized financial assets under Statement No. 133, eliminating a long-standing (but always intended to be temporary) exemption from Statement No. 133 for such financial instruments. As a result of the Statement, entities will have to determine if such interests may be (1) freestanding derivatives, (2) hybrid financial instruments containing embedded derivatives requiring bifurcation, or (3) hybrid financial instruments containing embedded derivatives that do not require bifurcation. In addition, the Statement permits fair value remeasurement for any hybrid instrument that contains an embedded derivative that would otherwise have to be bifurcated.

Table of Contents

The Statement is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity s first fiscal year beginning after September 15, 2006. Earlier adoption of the Statement is permitted as of the beginning of an entity s fiscal year, provided the entity has not yet issued financial statements for any interim period of that fiscal year. The adoption of this standard is not expected to have a material impact on the Company s financial condition, the results of operations, or liquidity.

Note 2. Discontinued Operations

In August 2004, the Company sold its mortgage banking subsidiary. The transaction completed the Company s exit from the mortgage banking business segment.

The business related to the former mortgage banking subsidiary is accounted for as discontinued operations and, therefore, the results of operations and cash flows have been removed from the Company s results of continuing operations in accordance with SFAS 144 for all periods presented in this report. Results of the former mortgage subsidiary are presented as discontinued operations in a separate category on the income statement relating to the 2005 period following results from continuing operations. The results of discontinued operations for the three and six months ended June 30, 2005, are presented below. The Company had no related income or loss from discontinued operations in 2006.

(Amounts in thousands)		**Three Months Ended June 30, 2005**		**Six Months Ended June 30, 2005**
Interest Income	$		$	
Interest Expense				
Net interest income				
Other Income				
Other Expense		39		170
Loss before income taxes		(39)		(170)
Applicable income tax benefit		(15)		(66)
Net Loss	$	(24)	$	(104)

All assets and liabilities of the mortgage banking subsidiary were disposed of in the third quarter of 2004. Accordingly, there were no assets or liabilities related to discontinued operations included in the June 30, 2006, or the December 31, 2005, consolidated balance sheets.

The cash flows resulting from discontinued operations have been revised to conform to the current year s presentation, which details cash flows from operating, investing, and financing activities.

Note 3. Mergers, Acquisitions and Branch Development

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

In March 2006, the Company entered into a definitive agreement to sell its branch location in Rowlesburg, West Virginia. The branch had deposits and repurchase agreements totaling approximately $10.7 million and loans of approximately $3.2 million at December 31, 2005. The transaction is expected to result in a pre-tax gain of approximately $382 thousand, and is expected to be completed by December 31, 2006.

Table of Contents

Note 4. Investment Securities

As of June 30, 2006, and December 31, 2005, the amortized cost and estimated fair value of available for sale securities are as follows:

	June 30, 2006			
(Amounts in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Government agency securities	$ 92,717	$	$ (3,360)	$ 89,357
States and political subdivisions	147,678	1,479	(2,789)	146,368
Corporate notes	61,520	254	(251)	61,523
Mortgage-backed securities	103,905	67	(3,432)	100,540
Equities	6,840	1,272	(139)	7,973
Total	$ 412,660	$ 3,072	$ (9,971)	$ 405,761

	December 31, 2005			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Government agency securities	$ 92,739	$	$ (1,315)	$ 91,424
States and political subdivisions	151,118	2,426	(1,376)	152,168
Corporate notes	61,466	125	(317)	61,274
Mortgage-backed securities	94,954	155	(2,115)	92,994
Equities	5,390	1,282	(151)	6,521
Total	$ 405,667	$ 3,988	$ (5,274)	$ 404,381

As of June 30, 2006, and December 31, 2005, the amortized cost and estimated fair value of held to maturity securities are as follows:

	June 30, 2006			
(Amounts in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
States and political subdivisions	$ 20,255	$ 425	$ (8)	$ 20,672
Mortgage-backed securities	11			11
Other securities	375		(1)	374
Total	$ 20,641	$ 425	$ (9)	$ 21,057

	December 31, 2005			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
States and political subdivisions	$ 23,781	$ 706	$ (1)	$ 24,486
Mortgage-backed securities	17			17
Other securities	375		(1)	374
Total	$ 24,173	$ 706	$ (2)	$ 24,877

Management does not believe any individual unrealized loss as of June 30, 2006, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes the declines in value are attributable to changes in market interest rates and not the credit quality of the issuer.

Table of Contents

The following table reflects those investments in an unrealized loss position at June 30, 2006, and December 31, 2005. There were no securities 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.

	June 30, 2006					
	Less than 12 Months		12 Months or longer		Total	
(Amounts in thousands) **Description of Securities**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U. S. Government agency securities	$ 59,440	$ (1,858)	$ 29,918	$ (1,502)	$ 89,358	$ (3,360)
States and political subdivisions	54,933	(1,562)	26,877	(1,235)	81,810	(2,797)
Other securities	32,629	(252)			32,629	(252)
Mortgage-backed securities	29,374	(393)	66,621	(3,039)	95,995	(3,432)
Equity securities	2,322	(137)	14	(2)	2,336	(139)
Total	$ 178,698	$ (4,202)	$ 123,430	$ (5,778)	$ 302,128	$ (9,980)

	December 31, 2005					
	Less than 12 Months		12 Months or longer		Total	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U. S. Government agency securities	$ 61,469	$ (722)	$ 29,851	$ (593)	$ 91,320	$ (1,315)
States and political subdivisions	47,706	(830)	18,583	(547)	66,289	(1,377)
Other securities	41,523	(318)			41,523	(318)
Mortgage-backed securities	40,651	(952)	45,607	(1,163)	86,258	(2,115)
Equity securities	1,786	(129)	99	(22)	1,885	(151)
Total	$ 193,135	$ (2,951)	$ 94,140	$ (2,325)	$ 287,275	$ (5,276)

Note 5. Loans

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

	June 30, 2006		December 31, 2005	
(Dollars in thousands)	**Amount**	**Percent**	**Amount**	**Percent**
Loans held for investment:				
Commercial and agricultural	$ 108,749	8.25%	$ 110,211	8.28%
Commercial real estate	434,161	32.92%	464,510	34.90%
Residential real estate	514,019	38.97%	504,386	37.89%
Construction	160,685	12.18%	143,976	10.82%
Consumer	99,018	7.51%	106,148	7.97%
Other	2,311	0.17%	1,808	0.14%
Total	$ 1,318,943	100.00%	$ 1,331,039	100.00%

Loans held for sale	$ 1,293	$ 1,274

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized on the balance sheet. The contractual amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company s exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Table of Contents

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

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

Financial instruments whose contract amounts represent credit risk at June 30, 2006, are commitments to extend credit (including availability of lines of credit) of $201.3 million and standby letters of credit and financial guarantees written of $4.9 million.

Note 6. Allowance for Loan Losses

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

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

The following table details the Company s allowance for loan loss activity for the three- and six-month periods ended June 30, 2006 and 2005.

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
(Amounts in thousands)	**2006**	**2005**	**2006**	**2005**
Beginning balance	$ 14,797	$ 16,543	$ 14,736	$ 16,339
Provision for loan losses	811	1,073	1,219	1,764
Charge-offs	(1,389)	(1,638)	(2,104)	(2,482)
Recoveries	491	398	859	755
Reclassification of allowance for lending-related commitments		(392)		(392)
Ending balance	$ 14,710	$ 15,984	$ 14,710	$ 15,984

Note 7. Deposits

The following is a summary of interest-bearing deposits by type as of June 30, 2006, and December 31, 2005.

(Amounts in thousands)	**June 30, 2006**	**December 31, 2005**
Interest-bearing demand deposits	$ 139,861	$ 144,314
Savings deposits	344,436	355,184
Certificates of deposit	675,165	675,904
Total	$ 1,159,462	$ 1,175,402

Note 8. Borrowings

The following schedule details the Company s Federal Home Loan Bank (FHLB) borrowings and other indebtedness at June 30, 2006, and December 31, 2005.

(Amounts in thousands)	**June 30, 2006**	**December 31, 2005**
FHLB borrowings	$ 188,694	$ 113,767
Subordinated debt	15,464	15,464
Total	$ 204,158	$ 129,231

FHLB borrowings include $182.3 million in convertible and callable advances and $6.4 million of noncallable term advances from the FHLB of Atlanta at June 30, 2006. The weighted average interest rates of advances are 4.46% and 4.17% at June 30, 2006, and December 31, 2005, respectively.

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 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 is 4.27% at June 30, 2006.

At June 30, 2006, the FHLB advances have maturities between six months and 15 years. The scheduled maturities of the advances are as follows:

	Amount *(in thousands)*
2006	$ 365
2007	6,250
2008	
2009	
2010	25,000
2011 and thereafter	157,079
Total	$ 188,694

The callable advances may be redeemed at quarterly intervals after various lockout periods. These call options may substantially shorten the lives of these instruments. If these advances are called, the debt may be paid in full, converted to another FHLB credit product, or converted to a fixed or adjustable rate advance. Prepayment of the advances may result in substantial penalties based upon the differential between contractual note rates and current

advance rates for similar maturities. Advances from the FHLB are secured by stock in the FHLB of Atlanta, qualifying first mortgage loans, mortgage-backed securities, and certain other securities.

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

Table of Contents

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

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

Note 9. Commitments and Contingencies

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

Note 10. Equity-Based Compensation

The Company maintains share-based compensation plans to encourage and facilitate investment in the common stock of the Company by key executives and to assist in the long-term retention of service by those executives. The Company has made stock option awards to officers and directors under a total of four stock-based compensation plans. Non-qualified and incentive stock options, as well as restricted and unrestricted stock may continue to be awarded under the 2004 Omnibus Stock Option Plan. Vesting under the 2004 plan is generally over a three-year period.

The Company adopted FASB Statement No. 123R, Share-Based Payment (SFAS 123R), on January 1, 2006, using the modified prospective method. Under this method, awards that are granted, modified, or settled after December 31, 2005, are measured and accounted for in accordance with SFAS 123R. Also under this method, expense is recognized for unvested awards that were granted prior to January 1, 2006, based upon the fair value determined at the grant date under FASB Statement No. 123, Accounting for Stock-Based Compensation (SFAS 123). Prior to the adoption of SFAS 123R, the Company accounted for stock compensation under the intrinsic value method permitted by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. Accordingly, the Company previously recognized no compensation cost for employee stock options that were granted with an exercise price equal to the market value of the underlying common stock on the date of grant.

Table of Contents

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 in 2005.

(Dollars in thousands, except per share data)	**Three Months Ended June 30, 2005**	**Six Months Ended June 30, 2005**
Net income as reported	$ 6,200	$ 12,171
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(47)	(91)
Pro forma net income	$ 6,153	$ 12,080
Income from continuing operations	$ 6,224	$ 12,275
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(47)	(91)
Pro forma income from continuing operations	$ 6,177	$ 12,184
Earnings per share:		
Basic as reported	$ 0.55	$ 1.08
Basic pro forma	$ 0.55	$ 1.07
Diluted as reported	$ 0.55	$ 1.07
Diluted pro forma	$ 0.54	$ 1.07
Earnings per share from continuing operations:		
Basic as reported	$ 0.55	$ 1.09
Basic pro forma	$ 0.55	$ 1.08
Diluted as reported	$ 0.55	$ 1.08
Diluted pro forma	$ 0.54	$ 1.07

Prior to the adoption of SFAS 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options and the vesting of restricted stock as operating cash flows in the Consolidated Statements of Cash Flows. SFAS 123R requires the cash flows from the tax benefits resulting from tax deductions in excess of the compensation expense recognized for those options and restricted stock (excess tax benefits) to be classified as financing cash flows. An excess tax benefit totaling $105 thousand is classified as a financing cash inflow for the six months ended June 30, 2006.

As a result of adopting SFAS 123R, pre-tax income and net income for the three months ended June 30, 2006, are approximately $69 thousand and $41 thousand lower, respectively, than accounting for stock options under the intrinsic value method. Pre-tax income and net income for the six months ended June 30, 2006, are approximately $140 thousand and $84 thousand lower, respectively. The increased compensation expense resulting from the adoption of SFAS 123R had no effect on basic or diluted earnings per share for the three and six month periods ended June 30, 3006.

During the three and six months ended June 30, 2006, the Company recognized pre-tax compensation expense related to total equity-based compensation of approximately $95 thousand and $283 thousand, respectively.

As of June 30, 2006, there was approximately $585 thousand of unrecognized compensation cost related to unvested stock options. That cost is expected to be recognized over a weighted average period of 1.4 years. The actual compensation cost recognized will differ from this estimate due to a number of items, including new awards granted and changes in estimated forfeitures.

Table of Contents

A summary of the Company s stock option activity, and related information for the six months ended June 30, 2006, is as follows:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value *(In thousands)*
Outstanding at January 1, 2006	383,562	$ 22.08		
Granted	1,000	31.06		
Exercised	(19,942)	16.15		
Forfeited	(3,182)	27.47		
Outstanding at June 30, 2006	361,438	$ 22.39	11.8	$ 3,833
Exercisable at June 30, 2006	248,721	$ 21.48	10.8	$ 2,862

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and certain assumptions. The fair values of grants made in the six month periods ended June 30, 2006 and 2005, were estimated using the following weighted average assumptions:

	Six Months Ended June 30,	
	2006	**2005**
Volatility	28.50%	28.62%
Expected dividend yield	3.35%	3.59%
Expected term (years)	6.00	6.00
Risk-free rate	4.69%	3.80%

The weighted average grant-date fair value of options granted during the six months ended June 30, 2006 and 2005, was $7.57 and $6.71, respectively. The aggregate intrinsic value of options exercised during the six months ended June 30, 2006 and 2005, was approximately $348 thousand and $58 thousand, respectively.

Stock Awards

The 2004 Omnibus Stock Option Plan permits the granting of restricted and unrestricted stock grants either alone, in addition to, or in tandem with other awards made by the Company. Stock grants are generally measured at fair value on the date of grant based on the number of shares granted and the quoted price of the Company s stock. Such value is recognized as expense over the corresponding service period. Compensation costs related to these types of awards are consistently reported for all periods presented.

Table of Contents

The following table summarizes the status of the Company s nonvested shares as of June 30, 2006, and changes during the six months then ended.

	Nonvested Shares	Weighted Average Grant-Date Fair Value
Nonvested at January 1, 2006	4,000	$ 26.24
Granted	4,532	31.39
Vested	(5,132)	29.67
Nonvested at June 30, 2006	3,400	$ 27.93

- 16 -

PART I.

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

The following discussion and analysis is provided to address information about First Community Bancshares, Inc. s (the Company) financial condition and results of operations. This discussion and analysis should be read in conjunction with the Company s 2005 Annual Report on Form 10-K and the other financial information included in this report.

The Company is a multi-state bank holding company headquartered in Bluefield, Virginia, with total assets of $1.98 billion at June 30, 2006. Through its community bank subsidiary, First Community Bank, N. A. (the Bank), the Company provides financial, trust and investment advisory services to individuals and commercial customers through fifty-nine banking locations and six wealth management offices located in the four states of Virginia, West Virginia, North Carolina and Tennessee. The Bank is the parent of Stone Capital Management, a SEC-registered investment advisory firm that offers wealth management and investment advice. The Company s common stock is traded on the NASDAQ Global Select Market under the symbol FCBC .

FORWARD LOOKING STATEMENTS

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

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

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

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

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

inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by third party sources, when available. When third party information is not available, valuation adjustments are estimated by management primarily through the use of internal modeling techniques and appraisal estimates.

The Company s accounting policies are fundamental to understanding Management s Discussion and Analysis of Financial Condition and Results of Operation. The disclosures presented in the Notes to the Consolidated Financial Statements and in Management s Discussion and Analysis provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified i.) the determination of the allowance for loan losses, ii.) accounting for acquisitions and intangible assets, and iii.) accounting for income taxes as the accounting areas that require the most subjective or complex judgments. The identified critical accounting policies are described in detail in the Company s 2005 Annual Report on Form 10-K. There have been no material changes in the Company s critical accounting policies since December 31, 2005.

EXECUTIVE OVERVIEW

The Company is a full service commercial bank holding company which operates within the four-state region of Virginia, West Virginia, North Carolina, and Tennessee. The Company operates through the Bank, and offers a wide range of financial services. The Company reported total assets of $1.98 billion at June 30, 2006, and operates through fifty-nine banking offices and six wealth management offices.

The Company funds its lending activities primarily through the retail deposit operations of its branch banking network. Borrowings from the Federal Home Loan Bank (FHLB) provide additional funding as needed. The Company invests its funds primarily in loans to retail and commercial customers. In addition to loans, the Company also invests a portion of its funds in various debt securities, including those of United States agencies, state and political subdivisions, and certain corporate notes and debt instruments. The Company also maintains overnight interest-bearing balances with the FHLB and correspondent banks. The difference between interest earned on assets and interest paid on liabilities is the Company s primary source of earnings. In August 2004, the Company divested itself of its mortgage subsidiary.

RECENT ACQUISITIONS AND BRANCHING ACTIVITY

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

In March 2006, the Company entered into a definitive agreement to sell its branch office in Rowlesburg, West Virginia. The branch had deposits and repurchase agreements totaling approximately $10.7 million and loans of approximately $3.2 million at December 31, 2005. The transaction is expected to result in a gain of approximately $382 thousand, and is expected to be completed by December 31, 2006.

The two transactions are a result of the Company s current strategic review of its branch network, and the resources will be re-deployed in markets which offer improved growth and development opportunities.

RESULTS OF OPERATIONS

Overview

Net income for the three months ended June 30, 2006, was $7.3 million or $0.65 per basic and diluted share, compared with $6.2 million or $0.55 per basic and diluted share for the three months ended June 30, 2005. Return on average equity for the three months ended June 30, 2006 was 14.74% compared to 13.19% for the three months ended June 30, 2005. Return on average assets was 1.47% for the three months ended June 30, 2006, compared to 1.31% for the three months ended June 30, 2005.

Net income for the six months ended June 30, 2006, was $14.1 million or $1.26 per basic and $1.25 per diluted share, compared with $12.2 million or $1.08 per basic and $1.07 per diluted share for the six months ended June 30, 2005. Return on average equity for the six months ended June 30, 2006 was 14.42% compared to 13.09% for the six months ended June 30, 2005. Return on average assets was 1.45% for the six months ended June 30, 2006, compared to 1.31% for the six months ended June 30, 2005.

Net Interest Income Quarterly Comparison (See Table I)

Net interest income, the largest contributor to earnings, was $18.2 million for the three months ended June 30, 2006, compared to $18.5 million for the corresponding period in 2005. Tax-equivalent net interest income totaled $19.2 million for the three months ended June 30, 2006, a decrease of $374 thousand from $19.5 million for the second three months of 2005. The decrease was due partly to increases in rates paid on liabilities which outpaced increases in the rates earned on assets. The Company also acquired $25 million of bank-owned life insurance (BOLI), which shifted that amount from earning assets to other assets and the related income from interest income to other income.

Compared to the second three months of 2005, average earning assets increased $58.1 million while interest-bearing liabilities increased $69.8 million during the second three months of 2006. The yield on average earning assets increased 51 basis points to 6.92% from 6.41%. Total cost of interest-bearing liabilities increased 83 basis points during the same period, which resulted in a net interest rate spread (the difference between interest income on earning assets and expense on interest bearing liabilities) that was 32 basis points lower at 3.82% compared to 4.14% for the same period last year. The Company s tax-equivalent net interest margin of 4.28% for the three months ended June 30, 2006, decreased 23 basis points from 4.51% in 2005.

The largest contributor to the increase in the yield on average earning assets in 2006 was the increase in the rate earned on the loan portfolio. The increase in the rate to 7.40% from 6.85%, attributable to the general rise in market rates of interest, resulted in a $1.8 million increase in tax-equivalent interest income compared to the second quarter of 2005. The increase in the loan portfolio contributed approximately $521 thousand to the change in interest income. The volume of variable rate loans tied to prime and other indices increased in response to the recent increases in short-term interest rates.

During the three months ended June 30, 2006, the tax-equivalent yield on securities available for sale increased 53 basis points to 5.52%, while the average balance increased by $20.1 million. The average tax-equivalent yield increased due to the addition of higher rate securities and the reduction of lower rate securities.

Compared to the second three months of 2005, average interest-bearing balances with banks increased to $41.4 million during the second three months of 2006, as the yield increased 158 basis points to 4.65%.

Compared to the same period in 2005, the average balances of interest-bearing demand and savings deposits decreased $7.3 million and $3.0 million, respectively, for the three months ended June 30, 2006. The average rate paid on interest-bearing demand deposits increased by 5 basis points, while the average rate paid on savings increased 106 basis points. Average time deposits increased $24.0 million while the average rate paid increased 98 basis points from 2.79% in 2005 to 3.77% in 2006. The level of average non-interestbearing demand deposits increased $12.0 million to $240.3 million during the quarter ended June 30, 2006, compared to the corresponding period of the prior year.

The changes in average deposits between the two quarters include the effect of the previously disclosed sale of the Company s Clifton Forge, Virginia, branch office. The changes also include the effects of the divestiture of the Drakes Branch, Virginia, branch office, although to a very small degree, because the sale was late in June.

Compared to the same period in 2005, average federal funds purchased and repurchase agreements increased $11.1 million to $136.5 million during the second quarter of 2006, while the average rate increased 130 basis points. The average balance of FHLB borrowings and other long-term debt increased by $45.0 million in 2006 to $204.2 million, while the rate paid on those borrowings decreased 56 basis points. The significant decrease in the rate is due to the FHLB debt restructuring near year-end 2005, where the Company paid off high interest rate obligations. The restructuring reduced the interest rate paid on $50 million of effectively fixed-rate FHLB borrowings by approximately 1.63%, and the rate paid on $25 million of floating-rate borrowings by 1.86% at the time of the transaction.

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

Net interest income was $36.2 million for the six months ended June 30, 2006, compared to $36.3 million for the corresponding period in 2005. Tax-equivalent net interest income totaled $38.2 million for the six months ended June 30, 2006, a decrease of $148 thousand from the $38.4 million for the first six months of 2005. The increase reflects a $351 thousand increase due to increased volume, which was completely offset by a $499 thousand decrease due to net rate changes on the liabilities.

During the first six months of 2006, average earning assets increased $70.5 million while interest-bearing liabilities increased $74.7 million over the comparable period. The yield on average earning assets increased 52 basis points to 6.85% from 6.33% for the six months ended June 30, 2005. Total cost of interest-bearing liabilities increased 82 basis points during the

same period, leaving the net interest rate spread 30 basis points lower at 3.84% compared to 4.14% for the same period last year. The Company s tax-equivalent net interest margin of 4.30% for the six months ended June 30, 2006, decreased 19 basis points from 4.49% in 2005.

The largest contributor to the increase in the yield on average earning assets in 2006, on a volume-weighted basis, was the increase in the rate earned on the loan portfolio. The increase in the rate to 7.34% from 6.77%, attributable to the general rise in market rates of interest, resulted in a $3.7 million increase in tax-equivalent interest income compared to the first six months of 2005. The increase in the loan portfolio contributed approximately $1.8 million to the change in interest income. The volume of variable rate loans tied to prime and other indices increased in response to the recent increases in short-term interest rates.

During the six months ended June 30, 2006, the tax-equivalent yield on securities available for sale increased 45 basis points to 5.39% while the average balance increased by $20.1 million. Although the total portfolio decreased through the period, the average tax-equivalent yield increased due to the addition of higher-rate securities and the reduction of lower-rate securities.

Compared to the first six months of 2005, average interest-bearing balances with banks increased to $35.1 million during the six months of 2006, while the yield increased 152 basis points to 4.44%.

The average balances of interest-bearing demand and savings deposits decreased $7.1 million and $9.7 million, respectively, for the six months ended June 30, 2006. The average rate paid on interest-bearing demand deposits increased 5 basis points, while the average rate paid on savings increased 97 basis points. Average time deposits increased $35.1 million while the average rate paid increased 97 basis points from 2.68% in 2005 to 3.65% in 2006. The increases in rates paid are attributable to the general rise in market rates of interest. The level of average non-interest-bearing demand deposits increased $12.0 million to $236.0 million through June 30, 2006, compared to the corresponding period of the prior year.

The changes in average deposits between the two periods include the effect of the previously disclosed sale of the Company s Clifton Forge, Virginia, branch office.

Compared to the same period in 2005, average federal funds purchased and repurchase agreements increased $6.2 million to $133.6 million for the first six months of 2006, and the average rate paid increased 127 basis points to 3.18%. The average balance of FHLB and other borrowings increased by $50.2 million in 2006 to $202.1 million, while the rate paid on those borrowings decreased 67 basis points. Like the quarterly comparison, the significant decrease in the rate is due to the FHLB debt restructuring near year-end 2005.

Table of Contents

Table I

AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

	Three Months Ended June 30, 2006			**Three Months Ended June 30, 2005**		
	Average Balance	**Interest (1)**	**Yield/ Rate (1)**	**Average Balance**	**Interest (1)**	**Yield/ Rate (1)**
			(Dollars in thousands)			
ASSETS						
Earning Assets:						
Loans: (2)						
Taxable	$ 1,327,278	$ 24,487	7.40%	$ 1,296,274	$ 22,175	6.86%
Tax-exempt	1,490	30	8.08%	3,084	28	3.64%
Total	1,328,768	24,517	7.40%	1,299,358	22,203	6.85%
Securities available for sale:						
Taxable	257,838	3,218	5.01%	243,680	2,548	4.19%
Tax-exempt	147,869	2,367	6.42%	141,932	2,247	6.35%
Total	405,707	5,585	5.52%	385,612	4,795	4.99%
Securities held to maturity:						
Taxable	388	5	5.17%	401	4	4.00%
Tax-exempt	20,990	427	8.16%	30,266	624	8.27%
Total	21,378	432	8.11%	30,667	628	8.21%
Interest-bearing deposits	41,361	479	4.65%	23,510	180	3.07%
Total Earning Assets	1,797,214	31,013	6.92%	1,739,147	27,806	6.41%
Other assets	187,527			152,186		
TOTAL ASSETS	$ 1,984,741			$ 1,891,333		
LIABILITIES						
Interest-bearing liabilities:						
Demand deposits	$ 148,502	$ 111	0.30%	$ 155,841	$ 98	0.25%
Savings deposits	355,826	1,761	1.99%	358,811	836	0.93%
Time deposits	686,161	6,454	3.77%	662,127	4,613	2.79%
Total interest-bearing deposits	1,190,489	8,326	2.81%	1,176,779	5,547	1.89%
Federal funds purchased and repurchase agreements	136,522	1,142	3.36%	125,415	645	2.06%
FHLB borrowings and other long-term debt	204,172	2,384	4.68%	159,147	2,079	5.24%
	1,531,183	11,852	3.10%	1,461,341	8,271	2.27%

Total interest-bearing liabilities						
Non-interestbearing demand deposits	240,296			228,307		
Other liabilities	14,822			13,153		
Stockholders Equity	198,440			188,532		
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,984,741			$ 1,891,333		
Net Interest Income, Tax Equivalent		$ 19,161			$ 19,535	
Net Interest Rate Spread (3)			3.82%			4.14%
Net Interest Margin (4)			4.28%			4.51%

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

amounts.

(2) Non-accrual loans are included in average balances outstanding but with no related interest income during the period of non-accrual.

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

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

Table of Contents

Table II

AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

	Six Months Ended June 30, 2006			Six Months Ended June 30, 2005		
	Average Balance	Interest (1)	Yield/ Rate (1)	Average Balance	Interest (1)	Yield/ Rate (1)
			(Dollars in thousands)			
ASSETS						
Earning Assets:						
Loans: (2)						
Taxable	$ 1,330,375	$ 48,391	7.34%	$ 1,276,295	$ 42,848	6.77%
Tax-exempt	1,531	62	8.17%	3,751	111	5.97%
Total	1,331,906	48,453	7.34%	1,280,046	42,959	6.77%
Securities available for sale:						
Taxable	254,702	6,091	4.82%	241,929	4,843	4.04%
Tax-exempt	149,991	4,726	6.35%	142,672	4,580	6.47%
Total	404,693	10,817	5.39%	384,601	9,423	4.94%
Securities held to maturity:						
Taxable	389	10	5.18%	404	8	3.99%
Tax-exempt	21,938	876	8.05%	31,346	1,288	8.29%
Total	22,327	886	8.00%	31,750	1,296	8.23%
Interest-bearing deposits	35,134	774	4.44%	27,119	393	2.92%
Total Earning Assets	1,794,060	60,930	6.85%	1,723,516	54,071	6.33%
Other assets	178,179			151,065		
TOTAL ASSETS	$ 1,972,239			$ 1,874,581		
LIABILITIES						
Interest-bearing liabilities:						
Demand deposits	$ 147,490	$ 217	0.30%	$ 154,589	$ 190	0.25%
Savings deposits	357,804	3,393	1.91%	367,467	1,705	0.94%
Time deposits	682,598	12,363	3.65%	647,489	8,614	2.68%
Total interest-bearing deposits	1,187,892	15,973	2.71%	1,169,545	10,509	1.81%
Federal funds purchased and repurchase agreements	133,566	2,103	3.18%	127,373	1,206	1.91%
FHLB borrowings and other long-term debt	202,118	4,634	4.62%	151,921	3,988	5.29%
	1,523,576	22,710	3.01%	1,448,839	15,703	2.19%

Total interest-bearing liabilities						
Non-interestbearing demand deposits	235,987			224,028		
Other liabilities	14,953			14,260		
Stockholders Equity	197,723			187,454		
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,972,239			$ 1,874,581		
Net Interest Income, Tax Equivalent		$ 38,220			$ 38,368	
Net Interest Rate Spread (3)			3.84%			4.14%
Net Interest Margin (4)			4.30%			4.49%

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

amounts.

(2) Non-accrual loans are included in average balances outstanding but with no related interest income during the period of non-accrual.

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

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

Table of Contents

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

	Three Months Ended June 30, 2006, Compared to 2005 $ Increase/(Decrease) due to			Six Months Ended June 30, 2006, Compared to 2005 $ Increase/(Decrease) due to		
(Amounts in thousands)	**Volume**	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest Earned On:						
Loans (1)	$ 521	$ 1,793	$ 2,314	$ 1,786	$ 3,708	$ 5,494
Securities available for sale (1)	249	541	790	498	896	1,394
Securities held to maturity (1)	(189)	(7)	(196)	(377)	(33)	(410)
Interest-bearing deposits with other banks	178	121	299	138	243	381
Total interest-earning assets	759	2,448	3,207	2,045	4,814	6,859
Interest Paid On:						
Demand deposits	(5)	18	13	(9)	36	27
Savings deposits	(7)	932	925	(46)	1,734	1,688
Time deposits	173	1,669	1,842	489	3,260	3,749
Fed funds purchased and repurchase agreements	62	435	497	61	836	897
FHLB borrowings and other long-term debt	542	(238)	304	1,200	(554)	646
Total interest-bearing liabilities	765	2,816	3,581	1,695	5,312	7,007
Change in net interest income, tax-equivalent	$ (6)	$ (368)	$ (374)	$ 350	$ (498)	$ (148)

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

Provision and Allowance for Loan Losses

The allowance for loan losses was $14.7 million at June 30, 2006, and December 31, 2005 and $16.0 million at June 30, 2005. The Company s allowance for loan loss activity for the three- and six-month periods ended June 30, 2006 and 2005, is as follows:

	For the Three Months ended June 30,	For the Six Months Ended June 30,

(Amounts in thousands)	**2006**	**2005**	**2006**	**2005**
Allowance for loan losses				
Beginning balance	$ 14,797	$ 16,543	$ 14,736	$ 16,339
Provision for loan losses	811	1,073	1,219	1,764
Charge-offs	(1,389)	(1,638)	(2,104)	(2,482)
Recoveries	491	398	859	755
Reclassification of allowance for lending-related commitments		(392)		(392)
Ending balance	$ 14,710	$ 15,984	$ 14,710	$ 15,984

The total allowance for loan losses to loans held for investment ratio was 1.12% at June 30, 2006, compared to 1.11% at December 31, 2005, and 1.23% at June 30, 2005. Management considers the allowance adequate based upon its analysis of the portfolio as of June 30, 2006. However, no assurances can be made that future adjustments to the allowance for loan losses will not be necessary as a result of increases in non-performing loans and other factors.
The provision for loan losses for the second quarter of 2006 was $811 thousand, a decrease of $262 thousand compared to $1.1 million in 2005. The provision for loan losses for the six-month period ended June 30, 2006, decreased to $1.2 million when compared to the six-month period ending June 30, 2005, of $1.8 million. The decrease in provision between all periods compared is primarily attributable to lower net charge-offs. Net charge-offs for the second quarter of 2006 were $898 thousand, compared to $1.2 million in 2005. Year-to-date net charge-offs were $1.2 million compared to $1.7 million in 2005.

Non-interest Income

Non-interest income consists of all revenues which are not included in interest and fee income related to earning assets. Non-interest income for the second quarter of 2006 was $5.5 million compared to $4.6 million in the same period of 2005, an increase of 21%. The second quarter of 2006 included $702 thousand in gain on the sale of the Drakes Branch, Virginia banking office. During the second quarter of 2006, the Company purchased $25 million of BOLI, which is the majority of the increase in other assets between December 31, 2005, and June 30, 2006. The increase in cash surrender value on that policy during the second quarter was approximately $249 thousand. The remaining components of non-interest income remained relatively stable between the two comparable quarterly periods.
Non-interest income for the first six months of 2006 was $10.7 million compared to $8.3 million for the same period of 2005. Included in the 2006 amount is a $676 thousand recovery related to an historical payments system fraud, in addition to the branch sale gain.

Non-interest Expense

Non-interest expense totaled $12.6 million for the quarter ended June 30, 2006, decreasing $713 thousand, or 5.4%, from the same period in 2005. Year-to-date non-interest expense was $25.9 million, an increase of less than one half of one percent over the 2005 comparable period. The quarterly decrease and lower year-to-date increase are the result of the Company s refocused efforts to control costs. Second quarter and year-to-date salaries and benefits decreased $670 thousand and $87 thousand, respectively, from the comparable prior year periods. Other operating expenses also decreased slightly between the comparable quarter and year-to-date periods.

Income Tax Expense

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are commonly referred to as permanent differences. The most significant permanent differences for the Company include i) income on state and municipal securities which are exempt from federal income tax, ii) certain dividend payments which are deductible by the Company, and iii) tax credits generated by investments in low income housing and historic rehabilitations.
For the second quarter of 2006, consolidated income taxes were $3.0 million compared to $2.5 million for the second quarter of 2005. For the quarters ended June 30, 2006 and 2005, the effective tax rates were 29.16% and 28.56%, respectively. The effective tax rate was higher during the current quarter due to a lower proportion of tax-free municipal security interest income than in the second quarter of 2005. For the first six months of 2006, consolidated income taxes were $5.6 million, a 28.48% effective tax rate, compared to $4.7 million, an effective tax rate of 27.71%, for the first six months of 2005.

Table of Contents

FINANCIAL POSITION

Total assets at June 30, 2006, increased $27 million to $1.98 billion from December 31, 2005, an annualized growth rate of 2.8%. The lower asset growth rate reflects the mid-year impact of the sale of one of the Company s banking offices (see Notes to the Consolidated Financial Statements).

Securities

Securities available for sale were $405.8 million at June 30, 2006, compared to $404.4 million at December 31, 2005, an increase of $1.4 million.

Securities held to maturity totaled $20.6 million at June 30, 2006, reflective of continuing paydowns, maturities and calls within the portfolio. The market value of investment securities held to maturity was 102.0% and 102.9% of book value at June 30, 2006, and December 31, 2005, respectively.

The Company s available-for-sale securities portfolio is reported at fair value. The fair value of most securities is determined based on quoted market prices. If quoted market prices are not available, fair value is determined based on quoted prices of similar instruments. Available-for-sale and held to maturity securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, the expectation for that security s performance, the creditworthiness of the issuer and the Company s intent and ability to hold the security to recovery or maturity. Management does not believe any unrealized loss, individually or in the aggregate, as of June 30, 2006, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes the decrease in value is attributable to changes in market interest rates and not the credit quality of the issuer.

Loan Portfolio

Loans Held for Sale: The $1.3 million balance of loans held for sale at June 30, 2006, represents long-term mortgage loans that are sold to investors on a best efforts basis. Accordingly, the Company does not retain the interest rate risk involved in the commitment. The gross notional amount of outstanding commitments at June 30, 2006, was $7.7 million on 50 loans.

Loans Held for Investment: Total loans held for investment remained relatively stable at $1.32 billion at June 30, 2006, compared to $1.33 billion at December 31, 2005, and increased $22.2 million from June 30, 2005. The average loan to deposit ratio increased to 92.9% for the second quarter of 2006, compared to 92.3% for the fourth quarter of 2005 and 92.5% for the second quarter of 2005. The 2006 year-to-date average loans of $1.33 billion increased $51.9 million when compared to the average for the first six months of 2005 of $1.28 billion.

The held for investment loan portfolio continues to be diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition as of June 30, 2006, December 31, 2005 and June 30, 2005.

	June 30, 2006		**December 31, 2005**		**June 30, 2005**	
(Dollars in thousands)	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Loans Held for Investment						
Commercial and agricultural	$ 108,749	8.25%	$ 110,211	8.28%	$ 103,565	7.99%
Commercial real estate	434,161	32.92%	464,510	34.90%	471,340	36.35%
Residential real estate	514,019	38.97%	504,386	37.89%	481,577	37.14%
Construction	160,685	12.18%	143,976	10.82%	126,678	9.77%
Consumer	99,018	7.51%	106,148	7.97%	111,654	8.61%
Other	2,311	0.17%	1,808	0.14%	1,914	0.14%
Total	$ 1,318,943	100.00%	$ 1,331,039	100.00%	$ 1,296,728	100.00%

Loans Held for Sale	$ 1,293	$ 1,274	$ 1,075

Non-Performing Assets

Non-performing assets include loans on non-accrual status, loans contractually past due 90 days or more and still accruing interest, other real estate owned (OREO), and repossessions. Non-performing assets were $3.9 million at June 30, 2006, $4.8 million at December 31, 2005, and $5.1 million at June 30, 2005. The percentage of non-performing assets to total loans, OREO and repossessions was 0.29% at June 30, 2006, down from 0.36% at December 31, 2005, and 0.40% at June 30, 2005.

The following schedule details non-performing assets by category at the close of each of the quarters ended June 30, 2006 and 2005, and December 31, 2005.

(Amounts in thousands)	**June 30, 2006**	**December 31, 2005**	**June 30, 2005**
Non-accrual	$ 2,937	$ 3,383	$ 4,132
Ninety days past due and accruing		11	
Other real estate owned	910	1,400	975
Repossessions	3	55	29
Total non-performing assets	$ 3,850	$ 4,849	$ 5,136
Restructured loans performing in accordance with modified terms	$ 289	$ 302	$ 327

At June 30, 2006, non-accrual loans decreased $446 thousand from December 31, 2005, and $1.2 million from June 30, 2005. The decrease in non-accrual loans is reflective of the Company s strict underwriting and improving credit quality. Ongoing activity within the classification and categories of non-performing loans continues to include collections on delinquencies, foreclosures and movements into or out of the non-performing classification as a result of changing customer business conditions. OREO of $910 thousand decreased from both June 30 and December 31, 2005, levels mostly as a result of property sales. OREO is carried at the lesser of estimated net realizable value or cost.

Deposits and Other Borrowings

Total deposits grew by $7.2 million during the first six months of 2006, net of the transfer of deposits in the Drakes Branch, Virginia, office. Non interest-bearing demand deposits increased by $23.1 million and interest-bearing demand deposits decreased $4.5 million. Savings decreased $10.7 million and time deposits decreased $739 thousand. In December 2005, the Company prepaid $77 million of FHLB advances, with interest rates ranging from 5.71% to 6.27%, with a weighted average rate and maturity of 5.96% and 4.3 years, respectively. In January 2006, the Company drew additional FHLB advances of $75 million, with a floating interest rate based on 3-month LIBOR, and which mature in fifteen years. The FHLB has the option, after five years, to convert the new advances to a fixed interest rate of 4%. Concurrent with the new advances, the Company entered into an interest rate swap agreement, effectively fixing the rate on $50 million of the new advances for five years. Under the terms of the swap, the Company will pay fixed interest payments of 4.335% on a notional $50 million, and receive floating interest rate payments of 3-month LIBOR less 45 basis points. The Company expects to save approximately $813 thousand in annual interest expense on the $50 million fixed by the interest rate swap. The remaining $25 million will float at an interest rate based on 3-month LIBOR. The initial interest rate on the floating portion of the FHLB advances is approximately 1.86% less than the weighted average rate of the prepaid advances. For further discussion of FHLB borrowings, see the Borrowings note to the Unaudited Consolidated Financial Statements included in this report.

Securities sold under repurchase agreements increased $25.4 million in the first six months of 2006. There were no federal funds purchased outstanding at June 30, 2006, as the Company has been in a fairly even liquidity position throughout the first six months of 2006.

Table of Contents

Stockholders Equity

Total stockholders equity increased $3.4 million from December 31, 2005, as the Company continued to balance capital adequacy and returns to stockholders. The increase in equity was due mainly to net earnings of $14.1 million after dividends paid to stockholders of $5.8 million, net changes of $2.5 million to treasury stock, and increases in other comprehensive loss of $2.5 million.

Risk-based capital guidelines and the leverage ratio measure capital adequacy of banking institutions. Risk-based capital guidelines weight balance sheet assets and off-balance sheet commitments based on inherent risks associated with the respective asset types. At June 30, 2006, the Company s total capital to risk-weighted assets ratio was 12.14% versus 11.65% at December 31, 2005. The Company s Tier 1 capital to risk-weighted assets ratio was 11.05% at June 30, 2006, compared to 10.54% at December 31, 2005. The Company s Tier 1 leverage ratio at June 30, 2006, was 8.06% compared to 7.77% at December 31, 2005. All of the Company s regulatory capital ratios exceed the current well-capitalized levels prescribed for banks.

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

At June 30, 2006, the Company maintained a significant level of liquidity in the form of cash and cash equivalent balances of $73.3 million, investment securities available for sale of $405.8 million, and FHLB credit availability of approximately $212.4 million. Cash and cash equivalents as well as advances from the FHLB are immediately available for satisfaction of deposit withdrawals, customer credit needs and operations of the Company. Investment securities available for sale represent a secondary level of liquidity available for conversion to liquid funds in the event of extraordinary needs. The Company also maintains approved lines of credit with correspondent banks as backup liquidity sources.

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

Interest Rate Risk and Asset/Liability Management

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

The Company s primary component of operational revenue, net interest income, is subject to variation as a result of changes in interest rate environments in conjunction with unbalanced repricing opportunities on earning assets and interest-bearing liabilities. Interest rate risk has four primary components 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 due to embedded options, often put or call options, given or sold to holders of financial instruments.

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

interest rate risk.

Specific strategies for management of interest rate risk have included shortening the amortized maturity of new fixed-rate loans, increasing the volume of adjustable-rate loans to reduce the average maturity of the Company s interest-earning assets and monitoring the term structure of liabilities to maintain a balanced mix of maturity and repricing structures to mitigate the potential exposure. Based upon the latest simulation, the Company believes that it is biased toward an asset sensitive

position. Absent adequate management, asset sensitive positions can negatively impact net interest income in a falling rate environment or, alternatively, positively impact net interest income in a rising rate environment.
The Company has established policy limits for tolerance of interest rate risk that allow for no more than a 10% reduction in projected net interest income based on a comparison of quarterly net interest income simulations in various interest rate scenarios. In addition, the policy addresses exposure limits to changes in the economic value of equity according to predefined policy guidelines. The most recent simulation indicates that current exposure to interest rate risk is within the Company s defined policy limits.
The following table summarizes the impact on net interest income and the economic value of equity as of June 30, 2006, and December 31, 2005, of immediate and sustained rate shocks in the interest rate environment of plus and minus 200 basis points from the base simulation, assuming no remedial measures are affected.

Rate Sensitivity Analysis

(Dollars in thousands)	**June 30, 2006**			
Increase (Decrease) in Interest Rates (Basis Points)	**Change in Net Interest Income**	**% Change**	**Change in Econcomic Value of Equity**	**% Change**
200	$ 1,290	1.7	$ 183	0.1
100	728	1.0	3,966	1.3
(100)	(794)	(1.0)	3,313	1.1
(200)	(2,635)	(3.5)	(7,899)	(2.6)

	December 31, 2005			
Increase (Decrease) in Interest Rates (Basis Points)	**Change in Net Interest Income**	**% Change**	**Change in Econcomic Value of Equity**	**% Change**
200	$ (764)	(1.0)	$ (13,392)	(4.6)
100	(403)	(0.5)	(6,211)	(2.2)
(100)	(950)	(1.3)	(4,376)	(1.5)
(200)	(4,299)	(5.8)	(15,755)	(5.5)

When comparing the impact of the rate shock analysis between June 30, 2006, and December 31, 2005, the changes in net interest income reflect relatively similar results and the impact of the balance sheet composition of assets and liabilities as the profile continues to reflect asset sensitivity. The asset sensitivity is reflected in on-hand liquidity in cash and cash equivalents of $73.3 million and in the loan portfolio which includes adjustable or variable rates on approximately 50% of the portfolio at June 30, 2006.
The economic value of equity is a measure which reflects the impact of changing rates of the underlying values of the Company s assets and liabilities in various rate scenarios. The scenarios illustrate the potential estimated impact of instantaneous rate shocks on the underlying value of equity. The economic value of the equity is based on the present value of all the future cash flows under the different rate scenarios.
Additionally, the Company entered into a pay fixed, receive variable derivative interest rate swap agreement in January 2006. The Company accounts for the derivate swap instrument as a cash flow hedge under the shortcut method allowed by FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. At June 30, 2006, the fair market value of the swap was approximately $1.5 million.

Table of Contents

PART I.

ITEM 4. Controls and Procedures

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

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

There have not been any changes in the Company s internal controls over financial reporting during the quarter ended June 30, 2006, that have materially affected, or are reasonably likely to materially affect, the Company s internal controls over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

There were no material changes to the risk factors as presented in the Company s annual report on Form 10-K for the year ended December 31, 2005.

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

(a) Not Applicable

(b) Not Applicable

(c) Issuer Purchases of Equity Securities

The following table sets forth open market purchases by the Company of its equity securities during the six months ended June 30, 2006.

	Total # of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that May yet be Purchased Under the Plan
January 1-31, 2006	23,161	$ 32.10	23,161	284,455
February 1-28, 2006	32,900	32.14	32,900	287,234
March 1-31, 2006	25,000	31.81	25,000	265,566
April 1-30, 2006	10,000	30.38	10,000	255,566
May 1-31, 2006	14,300	30.68	14,300	248,337
June 1-30, 2006	25,500	30.85	25,500	227,437
Total	130,861	$ 31.52	130,861	

The Company s stock repurchase plan, as amended, allows the purchase and retention of up to 550,000 shares. The plan has no expiration date and remains open. The Company held 322,563 shares in treasury at June 30, 2006.

ITEM 3. Defaults Upon Senior Securities

Not Applicable

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

Not Applicable

ITEM 5. Other Information

Not Applicable

Table of Contents

Item 6. Exhibits

(a) Exhibits

Exhibit No.	Exhibit
3(i)	Articles of Incorporation of First Community Bancshares, Inc., as amended. (1)
3(ii)	Bylaws of First Community Bancshares, Inc., as amended. (2)
4.1	Specimen stock certificate of First Community Bancshares, Inc. (3)
4.2	Indenture Agreement dated September 25, 2003. (11)
4.3	Amended and Restated Declaration of Trust of FCBI Capital Trust dated September 25, 2003. (11)
4.4	Preferred Securities Guarantee Agreement dated September 25, 2003. (11)
10.1	First Community Bancshares, Inc. 1999 Stock Option Contracts (2) and Plan. (4)*
10.1.1	Amendment to the First Community Bancshares, Inc. 1999 Stock Option Plan (12)*
10.2	First Community Bancshares, Inc. 2001 Non-Qualified Directors Stock Option Plan. (5)*
10.3	Employment Agreement dated January 1, 2000, and amended October 17, 2000, between First Community Bancshares, Inc. and John M. Mendez. (2)(6)*
10.4	First Community Bancshares, Inc. 2000 Executive Retention Plan, as amended. (4)*
10.5	First Community Bancshares, Inc. Split Dollar Plan and Agreement. (4)*
10.6	First Community Bancshares, Inc. 2001 Directors Supplemental Retirement Plan. (2)*
10.6.1	First Community Bancshares, Inc. 2001 Directors Supplemental Retirement Plan. Second Amendment (B. W. Harvey, Sr. October 19, 2004). (14)*
10.7	First Community Bancshares, Inc. Wrap Plan. (3)*
10.8	Employment Agreement between First Community Bancshares, Inc. and J. E. Causey Davis. (8)*
10.9	Form of Indemnification Agreement between First Community Bancshares, Inc., its Directors and Certain Executive Officers. (9)*
10.10	Form of Indemnification Agreement between First Community Bank, N. A., its Directors and Certain Executive Officers. (9)*
10.12	First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan (10) and Stock Award Agreement (13)*
10.13	Change of control agreement between First Community Bank, N. A. and Mark A. Wendel. (15)

31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
32	Certification of Chief Executive and Chief Financial Officer Section 1350.

* Management contract or compensatory plan or arrangement.

Table of Contents

(1) Incorporated by reference from the Quarterly Report on Form 10-Q for the period ended June 30, 2005, filed on August 5, 2005.

(2) Incorporated by reference from the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.

(3) Incorporated by reference from the Annual Report on Form 10-K for the period ended December 31, 2002, filed on March 25, 2003, as amended on March 31, 2003.

(4) Incorporated by reference from the Annual Report on Form 10-K for the period ended December 31, 1999, filed on March 30, 2000, as amended April 13, 2000.

(5) The option agreements entered into pursuant to the

1999 Stock Option Plan and the 2001 Non-Qualified Directors Stock Option Plan are incorporated by reference from the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.

(6) First Community Bancshares, Inc. has entered into substantially identical agreements with Robert L. Buzzo and E. Stephen Lilly, with the only differences being with respect to title, salary and the use of a vehicle.

(7) Not used.

(8) Incorporated by reference from S-4 Registration Statement filed on March 28, 2003. The Company has entered into a substantially identical contract with Phillip R. Carriger dated March 31, 2004.

(9)

Form of indemnification agreement entered into by the Corporation and by First Community Bank, N. A. with their respective directors and certain officers of each including, for the registrant and Bank: John M. Mendez, Robert L. Schumacher, Robert L. Buzzo, Kenneth P. Mulkey, E. Stephen Lilly and at the Bank level: Samuel L. Elmore. Incorporated by reference from the Annual Report on Form 10-K for the period ended December 31, 2003, filed on March 15, 2004, and amended on May 19, 2004.

(10) Incorporated by reference from the 2004 First Community Bancshares, Inc. Definitive Proxy filed on March 19, 2004.

(11) Incorporated by reference from the Quarterly Report on Form

10-Q for the period ended September 30, 2003 filed on November 10, 2003.

(12) Incorporated by reference from the Quarterly Report on Form 10-Q for the period ended March 31, 2004 filed on May 7, 2004.

(13) Incorporated by reference from the Quarterly Report on Form 10-Q for the period ended June 30, 2004 filed on August 6, 2004.

(14) Incorporated by reference from the Annual Report on Form 10-K for the period ended December 31, 2004, and filed on March 16, 2005. Amendments in substantially similar form were executed for Directors Clark, Kantor, Hamner, Modena, Perkinson, Stafford, and Stafford II but are not filed herewith.

(15) Incorporated by reference from the Annual Report on Form 10-K for the period ended December 31, 2005, and filed on March 15, 2006.

Table of Contents

SIGNATURES

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

First Community Bancshares, Inc.
DATE: August 9, 2006

/s/ John M. Mendez

John M. Mendez
President & Chief Executive Officer
(Duly Authorized Officer)

DATE: August 9, 2006

/s/ David D. Brown

David D. Brown
Chief Financial Officer
(Principal Accounting Officer)

- 34 -

Table of Contents

Index to Exhibits

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