

FIRST COMMUNITY BANCSHARES INC /NV/  
Form 10-Q  
November 07, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarter ended September 30, 2011**

**Commission file number 000-19297**

**FIRST COMMUNITY BANCSHARES, INC.**

**(Exact name of registrant as specified in its charter)**

**Nevada**  
**(State or other jurisdiction of**

**55-0694814**  
**(IRS Employer**

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incorporation)

Identification No.)

P.O. Box 989

Bluefield, Virginia  
(Address of principal executive offices)

24605-0989  
( 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 such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large accelerated filer  Accelerated filer

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

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

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

Class Common Stock, \$1.00 Par Value; 17,846,314 shares outstanding as of November 4, 2011

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**FIRST COMMUNITY BANCSHARES, INC.**

**FORM 10-Q**

**For the quarter ended September 30, 2011**

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

| <i>(Dollars in Thousands)</i>   | <b>September 30,<br/>2011<br/>(Unaudited)</b> | <b>December 31,<br/>2010</b> |
|---|---|------------------------------|
| <b>Assets</b>   |   |                              |
| Cash and due from banks   | \$ 38,776                                     | \$ 28,816                    |
| Federal funds sold  | 103,179                                       | 81,526                       |
| Interest-bearing balances with banks  | 6,365   | 1,847                        |
| <b>Total cash and cash equivalents</b>  | <b>148,320</b>                                | <b>112,189</b>               |
| Securities available-for-sale   | 449,387                                       | 480,064                      |
| Securities held-to-maturity   | 3,342   | 4,637                        |
| Loans held for sale   | 3,575   | 4,694                        |
| Loans held for investment, net of unearned income   | 1,374,656                                     | 1,386,206                    |
| Less allowance for loan losses  | 26,407  | 26,482                       |
| <b>Net loans held for investment</b>  | <b>1,348,249</b>                              | <b>1,359,724</b>             |
| Premises and equipment, net   | 54,860  | 56,244                       |
| Other real estate owned   | 5,942   | 4,910                        |
| Interest receivable   | 6,264   | 7,675                        |
| Goodwill  | 83,832  | 84,914                       |
| Other intangible assets   | 4,576   | 5,725                        |
| Other assets  | 111,745                                       | 123,462                      |
| <b>Total assets</b>   | <b>\$ 2,220,092</b>                           | <b>\$ 2,244,238</b>          |
| <b>Liabilities</b>  |   |                              |
| Deposits:   |   |                              |
| Noninterest-bearing   | \$ 233,683                                    | \$ 205,151                   |
| Interest-bearing  | 1,356,808                                     | 1,415,804                    |
| <b>Total deposits</b>   | <b>1,590,491</b>                              | <b>1,620,955</b>             |
| Interest, taxes and other liabilities   | 20,030  | 21,318                       |
| Securities sold under agreements to repurchase  | 139,510                                       | 140,894                      |
| FHLB borrowings   | 150,000                                       | 175,000                      |
| Other indebtedness  | 15,941  | 16,193                       |
| <b>Total Liabilities</b>  | <b>1,915,972</b>                              | <b>1,974,360</b>             |
| <b>Stockholders Equity</b>  |   |                              |
| Preferred stock, par value undesignated; 1,000,000 shares authorized; no shares issued or outstanding at September 30, 2011, or December 31, 2010   |   |                              |
| Series A preferred stock, \$0.01 par value; 25,000 shares authorized; 18,921 shares issued at September 30, 2011, and no shares issued at December 31, 2010   | 18,921  |                              |
| Common stock, \$1 par value; 50,000,000 shares authorized; 18,082,822 shares issued at September 30, 2011, and 18,082,822 issued at December 31, 2010, and 213,308 and 216,487 shares in treasury, respectively | 18,083  | 18,083                       |
| Additional paid-in capital  | 188,243                                       | 189,239                      |
| Retained earnings   | 92,498  | 81,486                       |
| Treasury stock, at cost   | (5,651)                                       | (6,740)                      |
| Accumulated other comprehensive loss  | (7,974)                                       | (12,190)                     |

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|  |              |              |
|--|--------------|--------------|
| Total stockholders' equity                 | 304,120      | 269,878      |
| Total Liabilities and Stockholders' Equity | \$ 2,220,092 | \$ 2,244,238 |

*See Notes to Consolidated Financial Statements.*

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)**

| <i>(Dollars In Thousands, Except Share and Per Share Data)</i> | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2011</b>                                 | <b>2010</b> | <b>2011</b>                                | <b>2010</b> |
| <b>Interest Income</b>   |   |             |  |             |
| Interest and fees on loans held for investment                 | \$ 20,084                                   | \$ 21,440   | \$ 60,633                                  | \$ 63,791   |
| Interest on securities taxable                                 | 1,711                                       | 2,895       | 6,094                                      | 10,411      |
| Interest on securities nontaxable                              | 1,180                                       | 1,451       | 4,004                                      | 4,271       |
| Interest on deposits in banks                                  | 75  | 54          | 244  | 134         |
| Total interest income  | 23,050                                      | 25,840      | 70,975                                     | 78,607      |
| <b>Interest Expense</b>  |   |             |  |             |
| Interest on deposits   | 2,998                                       | 4,872       | 10,151                                     | 15,480      |
| Interest on borrowings   | 2,318                                       | 2,371       | 7,061                                      | 7,369       |
| Total interest expense   | 5,316                                       | 7,243       | 17,212                                     | 22,849      |
| Net interest income  | 17,734                                      | 18,597      | 53,763                                     | 55,758      |
| Provision for loan losses                                      | 1,920                                       | 3,810       | 6,611                                      | 11,071      |
| Net interest income after provision for loan losses            | 15,814                                      | 14,787      | 47,152                                     | 44,687      |
| <b>Noninterest Income</b>                                      |   |             |  |             |
| Wealth management income                                       | 868   | 909         | 2,692                                      | 2,806       |
| Service charges on deposit accounts                            | 3,404                                       | 3,457       | 9,788                                      | 9,796       |
| Other service charges and fees                                 | 1,426                                       | 1,244       | 4,293                                      | 3,775       |
| Insurance commissions  | 1,523                                       | 1,663       | 5,027                                      | 5,253       |
| Total impairment losses on securities                          | (210)                                       |             | (737)                                      | (185)       |
| Portion of loss recognized in other comprehensive income       |   |             |  |             |
| Net impairment losses recognized in earnings                   | (210)                                       | -           | (737)                                      | (185)       |
| Net gains on sale of securities                                | 178   | 2,574       | 5,238                                      | 4,025       |
| Other operating income   | 877   | 1,091       | 2,627                                      | 2,950       |
| Total noninterest income                                       | 8,066                                       | 10,938      | 28,928                                     | 28,420      |
| <b>Noninterest Expense</b>                                     |   |             |  |             |
| Salaries and employee benefits                                 | 8,409                                       | 8,753       | 26,223                                     | 25,209      |
| Occupancy expense of bank premises                             | 1,476                                       | 1,573       | 4,691                                      | 4,852       |
| Furniture and equipment expense                                | 862   | 926         | 2,686                                      | 2,748       |
| Amortization of intangible assets                              | 250   | 260         | 770  | 769         |
| FDIC premiums and assessments                                  | 348   | 718         | 1,640                                      | 2,129       |
| Prepayment penalties on FHLB advances                          |   |             | 471  |             |
| Other operating expense  | 4,715                                       | 5,199       | 15,380                                     | 14,392      |
| Total noninterest expense                                      | 16,060                                      | 17,429      | 51,861                                     | 50,099      |
| Income before income taxes                                     | 7,820                                       | 8,296       | 24,219                                     | 23,008      |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Income tax expense                          | 2,502      | 1,743      | 7,422      | 6,046      |
| Net income                                  | 5,318      | 6,553      | 16,797     | 16,962     |
| Dividends on preferred stock                | 286        |            | 417        |            |
| Net income available to common shareholders | \$ 5,032   | \$ 6,553   | \$ 16,380  | \$ 16,962  |
| Basic earnings per common share             | \$ 0.28    | \$ 0.37    | \$ 0.92    | \$ 0.95    |
| Diluted earnings per common share           | \$ 0.28    | \$ 0.37    | \$ 0.91    | \$ 0.95    |
| Cash dividends per common share             | \$ 0.10    | \$ 0.10    | \$ 0.30    | \$ 0.30    |
| Weighted average basic shares outstanding   | 17,896,534 | 17,808,348 | 17,886,902 | 17,787,233 |
| Weighted average diluted shares outstanding | 19,205,634 | 17,832,882 | 18,533,364 | 17,812,895 |

*See Notes to Consolidated Financial Statements.*

**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

| <i>(Dollars In Thousands)</i>   | <b>Nine Months Ended<br/>September 30,</b> |                 |
|---|--|-----------------|
|   | <b>2011</b>                                | <b>2010</b>     |
| <b>Operating activities:</b>  |  |                 |
| Net income  | \$ 16,797                                  | \$ 16,962       |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |                 |
| Provision for loan losses   | 6,611                                      | 11,071          |
| Depreciation and amortization of premises and equipment                           | 3,030                                      | 3,050           |
| Intangible amortization   | 770  | 769             |
| Net investment amortization and accretion   | 1,047                                      | 542             |
| Net (gain) loss on the sale of property, plant, and equipment                     | (91)                                       | 341             |
| Net gain on the sale of securities  | (5,238)                                    | (4,025)         |
| Mortgage loans originated for sale  | (29,482)                                   | (28,101)        |
| Proceeds from sales of mortgage loans   | 31,132                                     | 36,856          |
| Gain on sales of loans  | (531)                                      | (565)           |
| Equity-based compensation expense   | 25   | 51              |
| Deferred income tax expense (benefit)   | 2,618                                      | (1,965)         |
| Decrease in interest receivable   | 1,411                                      | 711             |
| FHLB debt prepayment fees   | 471  |                 |
| Net impairment losses recognized in earnings                                      | 737  | 185             |
| Other operating activities, net   | 5,041                                      | 12,912          |
| <b>Net cash provided by operating activities</b>                                  | <b>34,348</b>                              | <b>48,794</b>   |
| <b>Investing activities:</b>  |  |                 |
| Proceeds from sales of securities available-for-sale                              | 191,397                                    | 142,936         |
| Proceeds from maturities and calls of securities available-for-sale               | 29,624                                     | 66,227          |
| Proceeds from maturities and calls of securities held-to-maturity                 | 1,300                                      | 1,544           |
| Purchase of securities available-for-sale   | (180,501)                                  | (208,720)       |
| Proceeds from (originations of) loans and leases                                  | 3,771                                      | (14,401)        |
| Proceeds from (investment in) the redemption of FHLB stock                        | 1,098                                      | (982)           |
| Cash provided by (invested in) acquisitions, net                                  | 1,586                                      | (667)           |
| Purchase of property, plant, and equipment  | (2,169)                                    | (2,374)         |
| Proceeds from sales of property, plant, and equipment                             | 565  | 37              |
| <b>Net cash provided by (used in) investing activities</b>                        | <b>46,671</b>                              | <b>(16,400)</b> |
| <b>Financing activities:</b>  |  |                 |
| Net increase in noninterest-bearing deposits                                      | 28,532                                     | 7,923           |
| Net (decrease) increase in interest-bearing deposits                              | (58,996)                                   | 3,340           |
| Net decrease in FHLB and other borrowings   | (25,252)                                   | (7,715)         |
| FHLB debt prepayment fees   | (471)                                      |                 |
| Net decrease in securities sold under agreement to repurchase                     | (1,384)                                    | (221)           |
| Proceeds from the exercise of stock options                                       | 32   | 30              |
| Net proceeds from the issuance of preferred stock                                 | 18,802                                     |                 |
| Excess tax benefit from stock-based compensation                                  | 5  | 9               |
| Repurchase of treasury stock  | (514)                                      |                 |
| Preferred dividends paid  | (274)                                      |                 |
| Common dividends paid   | (5,368)                                    | (5,337)         |
| <b>Net cash used in financing activities</b>                                      | <b>(44,888)</b>                            | <b>(1,971)</b>  |

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|  |            |            |
|--|------------|------------|
| Increase in cash and cash equivalents            | 36,131     | 30,423     |
| Cash and cash equivalents at beginning of period | 112,189    | 101,341    |
| Cash and cash equivalents at end of period       | \$ 148,320 | \$ 131,764 |
| <b>Supplemental information noncash items</b>    |            |            |
| Transfer of loans to other real estate           | \$ 7,511   | \$ 5,807   |

*See Notes to Consolidated Financial Statements.*

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**Table of Contents****FIRST COMMUNITY BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)**

|                                    | Preferred<br>Stock | Common<br>Stock                    | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total      |
|------------------------------------|--------------------|------------------------------------|----------------------------------|----------------------|-------------------|---|------------|
| <i>(Dollars in Thousands)</i>      |                    |                                    |                                  |                      |                   |   |            |
| Balance January 1, 2010            | \$                 | \$ 18,083                          | \$ 190,967                       | \$ 66,760            | \$ (9,891)        | \$ (13,652)   | \$ 252,267 |
| Comprehensive income:              |                    |                                    |                                  |                      |                   |   |            |
| Net income                         |                    |                                    |                                  | 16,962               |                   |   | 16,962     |
| Other comprehensive income         |                    | see note 9                         |                                  |                      |                   | 9,305   | 9,305      |
| Comprehensive income               |                    |                                    |                                  | 16,962               |                   | 9,305   | 26,267     |
| Common dividends declared and paid |                    |                                    |                                  |                      |                   |   |            |
| Issuance of vested shares          |                    | 800 shares                         | (25)                             |                      | 25                |   |            |
| Equity-based compensation expense  |                    |                                    | 51                               |                      |                   |   | 51         |
| Retirement plan contribution       |                    | 66,006 shares issued               | (1,130)                          |                      | 2,055             |   | 925        |
| Option exercises                   |                    | 2,631 shares                       | (52)                             |                      | 82                |   | 30         |
| Balance September 30, 2010         | \$                 | \$ 18,083                          | \$ 189,811                       | \$ 78,385            | \$ (7,729)        | \$ (4,347)  | \$ 274,203 |
| Balance January 1, 2011            |                    |                                    |                                  |                      |                   |   |            |
| Balance January 1, 2011            | \$                 | \$ 18,083                          | \$ 189,239                       | \$ 81,486            | \$ (6,740)        | \$ (12,190)   | \$ 269,878 |
| Comprehensive income:              |                    |                                    |                                  |                      |                   |   |            |
| Net income                         |                    |                                    |                                  | 16,797               |                   |   | 16,797     |
| Other comprehensive income         |                    | see note 9                         |                                  |                      |                   | 4,216   | 4,216      |
| Comprehensive income               |                    |                                    |                                  | 16,797               |                   | 4,216   | 21,013     |
| Common dividends declared and paid |                    |                                    |                                  |                      |                   |   |            |
| Preferred dividends declared       |                    |                                    |                                  | (5,368)              |                   |   | (5,368)    |
| Issuance of preferred stock        | 18,921             |                                    | (119)                            | (417)                |                   |   | (417)      |
| Issuance of vested shares          |                    |                                    | (22)                             |                      | 22                |   |            |
| Equity-based compensation expense  |                    |                                    | 17                               |                      | 8                 |   | 25         |
| Retirement plan contribution       |                    | 47,570 shares issued               | (812)                            |                      | 1,481             |   | 669        |
| Purchase of treasury shares        |                    | 48,310 shares at \$10.58 per share |                                  |                      | (514)             |   | (514)      |
| Option exercises                   |                    | 2,969 shares                       | (60)                             |                      | 92                |   | 32         |
| Balance September 30, 2011         | \$ 18,921          | \$ 18,083                          | \$ 188,243                       | \$ 92,498            | \$ (5,651)        | \$ (7,974)  | \$ 304,120 |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 1. General***Unaudited Consolidated Financial Statements*

The accompanying unaudited consolidated financial statements of First Community Bancshares, Inc. and subsidiaries ( First Community or the Company ) have been prepared in accordance with United States generally accepted accounting principles ( GAAP ) 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. All significant intercompany balances and transactions have been eliminated in consolidation. 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, 2010, has been derived from the audited consolidated financial statements included in the Company s 2010 Annual Report on Form 10-K (the 2010 Form 10-K ). Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with GAAP have been omitted in accordance with standards for the preparation of interim consolidated financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2010 Form 10-K.

A more complete and detailed description of First Community s significant accounting policies is included within Note 1 of Item 8, Financial Statements and Supplementary Data in the Company s 2010 Form 10-K. Further discussion of the Company s application of critical accounting policies is included within the Application of Critical Accounting Policies section of Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, included herein.

The Company operates within two business segments community banking and insurance services. Insurance services are comprised of agencies that sell property and casualty and life and health insurance policies and arrangements. All other operations, including commercial and consumer banking, lending activities, and wealth management are included within the banking segment.

*Earnings Per Share*

Basic earnings per share are determined by dividing net income available to common shareholders by the weighted average number of shares outstanding. Diluted earnings per share are determined by dividing net income by the weighted average shares outstanding, which includes the dilutive effect of stock options, warrants, contingently issuable shares, and convertible preferred shares. Basic and diluted net income per common share calculations follow:

| <i>(In Thousands, Except Share and Per Share Data)</i> | <b>For the Three Months<br/>Ended September 30,</b> |             | <b>For the Nine Months<br/>Ended September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2011</b>   | <b>2010</b> | <b>2011</b>  | <b>2010</b> |
| Net income   | \$ 5,318  | \$ 6,553    | \$ 16,797  | \$ 16,962   |
| Dividends on preferred stock                           | 286   |             | 417  |             |
| Net income available to common shareholders            | \$ 5,032  | \$ 6,553    | \$ 16,380  | \$ 16,962   |
| Weighted average shares outstanding                    | 17,896,534  | 17,808,348  | 17,886,902   | 17,787,233  |
| Diluted shares for stock options                       | 3,551   | 11,630      | 5,643  | 12,758      |
| Contingently issuable shares                           |   | 12,904      |  | 12,904      |
| Convertible preferred shares                           | 1,305,549   |             | 640,819  |             |
| Weighted average dilutive shares outstanding           | 19,205,634  | 17,832,882  | 18,533,364   | 17,812,895  |
| Basic earnings per share                               | \$ 0.28   | \$ 0.37     | \$ 0.92  | \$ 0.95     |
| Diluted earnings per share                             | \$ 0.28   | \$ 0.37     | \$ 0.91  | \$ 0.95     |

For the three- and nine-month periods ended September 30, 2011, options and warrants to purchase 480,045 and 480,221 shares, respectively, of common stock were outstanding but were not included in the computation of diluted earnings per



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common share because they would have an anti-dilutive effect. Likewise, options and warrants to purchase 491,189 shares of common stock were excluded from the three- and nine-month periods ended September 30, 2010, computation of diluted earnings per common share because their effect would be anti-dilutive.

### *Series A Preferred Stock*

On May 20, 2011, the Company completed a private placement of 18,921 shares of its Series A Preferred Stock. The shares carry a 6% dividend rate and are non-cumulative. Each share is convertible into 69 shares of the Company's common stock at any time and mandatorily convert after five years. The Company may redeem the shares at face value after the third anniversary.

### *Recent Accounting Pronouncements*

Financial Accounting Standards Board ( FASB ) Accounting Standard Codification ( ASC ) Topic 310, Receivables . New authoritative accounting guidance under ASC Topic 310 amends prior guidance to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables by providing additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The Company adopted the provisions of the new authoritative accounting guidance under ASC Topic 310 during the fourth quarter of 2010. Other than the additional disclosures, the adoption of the new guidance had no significant impact on the Company's financial statements.

In April 2011, FASB issued Accounting Standard Update ( ASU ) 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring, which clarifies when creditors should classify loan modifications as troubled debt restructurings. The guidance is effective for interim and annual periods beginning on or after June 15, 2011, and is applied retrospectively to restructurings at the beginning of the year of adoption. The guidance on measuring the impairment of a receivable restructured in a troubled restructuring is effective on a prospective basis. The Company adopted the new guidance during the third quarter of 2011 and the new disclosures are presented in Note 5 to the Consolidated Financial Statements.

In April 2011, FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements, which simplifies the accounting for financial assets transferred under repurchase agreements and similar arrangements by eliminating the transferor's ability criteria from the assessment of effective control over those assets as well as the related implementation guidance. The guidance is effective for interim and annual periods beginning on or after December 15, 2011, and is applied on a prospective basis. The Company is currently assessing the impact on its financial statements.

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in the U.S. GAAP and IFRS, which was issued primarily to provide largely identical guidance about fair value measurement and disclosure requirements for International Financial Reporting Standards ( IFRS ) and U.S. GAAP. The new standards do not extend the use of fair value but rather provide guidance about how fair value should be determined where it already is required or permitted under IFRS or U.S. GAAP. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. Public companies are required to apply the standard prospectively for interim and annual periods beginning after December 15, 2011. The Company is currently assessing the impact on its financial statements.

In June 2011, FASB issued ASU 2011-05, Presentation of Comprehensive Income, which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. The guidance does not change the items that must be reported in other comprehensive income. The guidance is effective for fiscal years and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The Company is currently assessing the impact on its financial statements.

In September 2011, FASB issued ASU 2011-08, Testing Goodwill for Impairment, which simplifies how an entity tests goodwill for impairment. The guidance permits an entity to first assess qualitative factors to determine whether it is necessary to perform additional impairment testing. The guidance is effective for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company is currently assessing the impact on its financial statements.

**Table of Contents****Note 2. Divestitures**

In July and August 2011, the Company sold three insurance agency offices. The Company recorded net gains of \$67 thousand on the sales of the offices and has the potential to recognize an additional \$650 thousand over time as earn-out payments are received. Annualized revenue and income before taxes from the three offices approximate \$572 thousand and \$5 thousand, respectively.

**Note 3. Investment Securities**

As of September 30, 2011, and December 31, 2010, the amortized cost and estimated fair value of available-for-sale securities were as follows:

| <i>(In Thousands)</i>                   | September 30, 2011 |                     |                      |                   |                   |
|---|--------------------|---------------------|----------------------|-------------------|-------------------|
|   | Amortized<br>Cost  | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value     | OTTI in<br>AOCI*  |
| States and political subdivisions       | \$ 124,582         | \$ 5,438            | \$ (1)               | \$ 130,019        | \$                |
| Single issue trust preferred securities | 55,631             |                     | (15,590)             | 40,041            |                   |
| Corporate FDIC insured                  | 13,758             | 17                  |                      | 13,775            |                   |
| Mortgage-backed securities:             |                    |                     |                      |                   |                   |
| Agency                                  | 248,480            | 6,051               | (111)                | 254,420           |                   |
| Non-Agency Alt-A residential            | 17,728             |                     | (7,130)              | 10,598            | (7,130)           |
| Total mortgage-backed securities        | 266,208            | 6,051               | (7,241)              | 265,018           | (7,130)           |
| Equity securities                       | 434                | 216                 | (116)                | 534               |                   |
| <b>Total</b>                            | <b>\$ 460,613</b>  | <b>\$ 11,722</b>    | <b>\$ (22,948)</b>   | <b>\$ 449,387</b> | <b>\$ (7,130)</b> |

| <i>(In Thousands)</i>             | December 31, 2010 |                     |                      |                   |                   |
|-----------------------------------|-------------------|---------------------|----------------------|-------------------|-------------------|
|                                   | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value     | OTTI in<br>AOCI*  |
| U.S. Government agency securities | \$ 10,000         | \$                  | \$ (168)             | \$ 9,832          | \$                |
| States and political subdivisions | 178,149           | 2,649               | (4,660)              | 176,138           |                   |
| Trust preferred securities:       |                   |                     |                      |                   |                   |
| Single issue                      | 55,594            |                     | (14,350)             | 41,244            |                   |
| Pooled                            | 23                | 241                 |                      | 264               |                   |
| Total trust preferred securities  | 55,617            | 241                 | (14,350)             | 41,508            |                   |
| Corporate FDIC insured            | 25,282            | 378                 |                      | 25,660            |                   |
| Mortgage-backed securities:       |                   |                     |                      |                   |                   |
| Agency                            | 209,281           | 7,039               | (1,307)              | 215,013           |                   |
| Non-Agency Alt-A residential      | 19,181            |                     | (7,904)              | 11,277            | (7,904)           |
| Total mortgage-backed securities  | 228,462           | 7,039               | (9,211)              | 226,290           | (7,904)           |
| Equity securities                 | 495               | 206                 | (65)                 | 636               |                   |
| <b>Total</b>                      | <b>\$ 498,005</b> | <b>\$ 10,513</b>    | <b>\$ (28,454)</b>   | <b>\$ 480,064</b> | <b>\$ (7,904)</b> |

\* Other-than-temporary impairment in accumulated other comprehensive income.

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As of September 30, 2011, and December 31, 2010, the amortized cost and estimated fair value of held-to-maturity securities were as follows:

| <i>(In Thousands)</i>             | Amortized<br>Cost | September 30, 2011  |                      | Fair<br>Value |
|-----------------------------------|-------------------|---------------------|----------------------|---------------|
|                                   |                   | Unrealized<br>Gains | Unrealized<br>Losses |               |
| States and political subdivisions | \$ 3,342          | \$ 42               | \$                   | \$ 3,384      |
| Total                             | \$ 3,342          | \$ 42               | \$                   | \$ 3,384      |

| <i>(In Thousands)</i>             | Amortized<br>Cost | December 31, 2010   |                      | Fair<br>Value |
|-----------------------------------|-------------------|---------------------|----------------------|---------------|
|                                   |                   | Unrealized<br>Gains | Unrealized<br>Losses |               |
| States and political subdivisions | \$ 4,637          | \$ 67               | \$                   | \$ 4,704      |
| Total                             | \$ 4,637          | \$ 67               | \$                   | \$ 4,704      |

The amortized cost and estimated fair value of available-for-sale securities by contractual maturity at September 30, 2011, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| <i>(In Thousands)</i>                     | Amortized<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
| Due within one year                       | \$ 450            | \$ 452        |
| Due after one year but within five years  | 27,527            | 28,044        |
| Due after five years but within ten years | 21,740            | 22,833        |
| Due after ten years                       | 144,254           | 132,506       |
|   | 193,971           | 183,835       |
| Mortgage-backed securities                | 266,208           | 265,018       |
| Equity securities                         | 434               | 534           |
| Total                                     | \$ 460,613        | \$ 449,387    |

The amortized cost and estimated fair value of held-to-maturity securities by contractual maturity at September 30, 2011, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| <i>(In Thousands)</i>                     | Amortized<br>Cost | Fair Value |
|---|-------------------|------------|
| Due within one year                       | \$ 901            | \$ 913     |
| Due after one year but within five years  | 2,441             | 2,471      |
| Due after five years but within ten years |                   |            |
| Due after ten years                       |                   |            |
| Total                                     | \$ 3,342          | \$ 3,384   |

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The carrying value of securities pledged to secure public deposits as required by law and for other purposes was \$292.32 million and \$302.67 million at September 30, 2011, and December 31, 2010, respectively.

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The following table presents the Company's gross gains and gross losses from the sale of securities for the three- and nine-month periods ended September 30, 2011 and 2010.

| <i>(In Thousands)</i>                   | <b>For the Three Months</b>     |                 | <b>For the Nine Months</b>      |                 |
|---|---------------------------------|-----------------|---------------------------------|-----------------|
|   | <b>Ended September 30, 2011</b> | <b>2010</b>     | <b>Ended September 30, 2011</b> | <b>2010</b>     |
| Gross gains                             | \$ 209                          | \$ 3,032        | \$ 6,889                        | \$ 4,517        |
| Gross losses                            | (31)                            | (458)           | (1,651)                         | (492)           |
| <b>Net gains on sales of securities</b> | <b>\$ 178</b>                   | <b>\$ 2,574</b> | <b>\$ 5,238</b>                 | <b>\$ 4,025</b> |

The following tables reflect those investments, both available-for-sale and held-to-maturity, in a continuous unrealized loss position for less than 12 months and for 12 months or longer at September 30, 2011, and December 31, 2010.

| <i>(In Thousands)</i>                   | <b>Less than 12 Months</b> |                          | <b>September 30, 2011<br/>12 Months or longer</b> |                          | <b>Total</b>      |                          |
|---|----------------------------|--------------------------|---|--------------------------|-------------------|--------------------------|
|   | <b>Fair Value</b>          | <b>Unrealized Losses</b> | <b>Fair Value</b>                                 | <b>Unrealized Losses</b> | <b>Fair Value</b> | <b>Unrealized Losses</b> |
| States and political subdivisions       | \$                         | \$                       | \$ 183  | \$ (1)                   | \$ 183            | \$ (1)                   |
| Single issue trust preferred securities |                            |                          | 40,041  | (15,590)                 | 40,041            | (15,590)                 |
| Mortgage-backed securities:             |                            |                          |   |                          |                   |                          |
| Agency                                  | 31,566                     | (111)                    | 17  |                          | 31,583            | (111)                    |
| Alt-A residential                       |                            |                          | 10,598  | (7,130)                  | 10,598            | (7,130)                  |
| Total mortgage-backed securities        | 31,566                     | (111)                    | 10,615  | (7,130)                  | 42,181            | (7,241)                  |
| Equity securities                       |                            |                          | 171   | (116)                    | 171               | (116)                    |
| Total                                   | \$ 31,566                  | \$ (111)                 | \$ 51,010   | \$ (22,837)              | \$ 82,576         | \$ (22,948)              |

| <i>(In Thousands)</i>                   | <b>Less than 12 Months</b> |                          | <b>December 31, 2010<br/>12 Months or longer</b> |                          | <b>Total</b>      |                          |
|---|----------------------------|--------------------------|--|--------------------------|-------------------|--------------------------|
|   | <b>Fair Value</b>          | <b>Unrealized Losses</b> | <b>Fair Value</b>                                | <b>Unrealized Losses</b> | <b>Fair Value</b> | <b>Unrealized Losses</b> |
| U.S. Government agency securities       | \$ 9,832                   | \$ (168)                 | \$   | \$                       | \$ 9,832          | \$ (168)                 |
| States and political subdivisions       | 80,420                     | (4,660)                  |  |                          | 80,420            | (4,660)                  |
| Single issue trust preferred securities |                            |                          | 41,244   | (14,350)                 | 41,244            | (14,350)                 |
| Mortgage-backed securities:             |                            |                          |  |                          |                   |                          |
| Agency                                  | 71,613                     | (1,307)                  | 18   |                          | 71,631            | (1,307)                  |
| Alt-A residential                       |                            |                          | 11,277   | (7,904)                  | 11,277            | (7,904)                  |
| Total mortgage-backed securities        | 71,613                     | (1,307)                  | 11,295   | (7,904)                  | 82,908            | (9,211)                  |
| Equity securities                       | 155                        | (55)                     | 93   | (10)                     | 248               | (65)                     |
| Total                                   | \$ 162,020                 | \$ (6,190)               | \$ 52,632  | \$ (22,264)              | \$ 214,652        | \$ (28,454)              |

At September 30, 2011, the combined depreciation in value of the 24 individual securities in an unrealized loss position was approximately 5.11% of the combined reported value of the aggregate securities portfolio. At December 31, 2010, the combined depreciation in value of the 214 individual securities in an unrealized loss position was approximately 5.93% of the combined reported value of the aggregate securities portfolio.

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The Company reviews its investment portfolio on a quarterly basis for indications of other-than-temporary impairment ( OTTI ). The analysis differs depending upon the type of investment security being analyzed. For debt securities, the Company has determined that it does not intend to sell securities that are impaired and has asserted that it is not more likely than not that the Company will have to sell impaired securities before recovery of the impairment occurs. This determination is based upon the Company s investment strategy for the particular type of debt security and its cash flow needs, liquidity position, capital adequacy and interest rate risk position.

For non-beneficial interest debt securities, the Company analyzes several qualitative factors such as the severity and duration of the impairment, adverse conditions within the issuing industry, prospects for the issuer, performance of the security,

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changes in rating by rating agencies and other qualitative factors to determine if the impairment will be recovered. Non-beneficial interest debt securities consist of U. S. government agency securities, states and political subdivisions, and single issue trust preferred securities. If it is determined that there is evidence that the impairment will not be recovered, the Company performs a present value calculation to determine the amount of credit related impairment and records any credit related OTTI through earnings and the non-credit related OTTI through other comprehensive income ( OCI ). During the three- and nine-month periods ended September 30, 2011, the Company incurred no OTTI charges related to non-beneficial interest debt securities. The temporary impairment on these securities is primarily related to changes in interest rates, certain disruptions in the credit markets, destabilization in the Eurozone, and other current economic factors.

For beneficial interest debt securities, the Company reviews cash flow analyses on each applicable security to determine if an adverse change in cash flows expected to be collected has occurred. Beneficial interest debt securities consist of pooled trust preferred securities, corporate FDIC insured, and mortgage-backed securities. An adverse change in cash flows expected to be collected has occurred if the present value of cash flows previously projected is greater than the present value of cash flows projected at the current reporting date and less than the current book value. If an adverse change in cash flows is deemed to have occurred, then an OTTI has occurred. The Company then compares the present value of cash flows using the current yield for the current reporting period to the reference amount, or current net book value, to determine the credit-related OTTI. The credit-related OTTI is then recorded through earnings and the non-credit related OTTI is accounted for in OCI.

During the three- and nine-month periods ended September 30, 2011, the Company incurred credit-related OTTI charges related to beneficial interest debt securities of \$210 thousand and \$737 thousand, respectively. These charges were related to a non-Agency mortgage-backed security ( MBS ). During the three-month period ended September 30, 2010, the Company incurred no credit-related OTTI charges related to beneficial interest debt securities. During the nine-month period ended September 30, 2010, the Company incurred credit-related OTTI charges on beneficial interest debt securities of \$134 thousand. These charges were related to two pooled trust preferred security holdings and brought the carrying value of those securities to zero.

For the non-Agency, Alt-A residential MBS, the Company models cash flows using the following assumptions: voluntary constant prepayment speed of 5, a customized constant default rate scenario that assumes approximately 23% of the remaining underlying mortgages will default, and a loss severity of 60.

The table below provides a cumulative roll forward of credit losses recognized in earnings for debt securities for which a portion of an OTTI is recognized in OCI:

| <i>(In Thousands)</i>   | <b>For the Three<br/>Months<br/>Ended September 30, 2011</b> | <b>For the Nine<br/>Months<br/>Ended September 30, 2011</b> |
|---|--|---|
| Estimated credit losses, beginning balance (1)                            | \$ 4,778   | \$ 4,251  |
| Additions for credit losses on securities not previously OTTI             |  |   |
| Additions for credit losses on securities previously OTTI                 | 210  | 737   |
| Reduction for increases in cash flows                                     |  |   |
| Reduction for securities management no longer intends to hold to recovery |  |   |
| Reduction for realized losses   |  |   |
| Estimated credit losses, ending balance                                   | \$ 4,988   | \$ 4,988  |

(1) The beginning balance includes credit-related losses included in OTTI charges recognized on debt securities in prior periods. For equity securities, the Company reviews for OTTI based upon the prospects of the underlying companies, analysts' expectations, and certain other qualitative factors to determine if impairment is recoverable over a foreseeable period of time. During the three- and nine-month periods ended September 30, 2011, the Company did not recognize any OTTI charges on equity securities. For the three months ended September 30, 2010, the Company recognized no OTTI charges on its equity securities. For the nine months ended September 30, 2010, the Company recognized OTTI charges on certain of its equity securities of \$51 thousand.

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As a condition to membership in the Federal Home Loan Bank ( FHLB ) system, the Company is required to subscribe to a minimum level of stock in the FHLB of Atlanta ( FHLBA ). The Company believes this ownership position provides access to relatively inexpensive wholesale and overnight funding. The Company accounts for FHLBA and Federal Reserve Bank stock as

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a long-term investment in other assets. At September 30, 2011, and December 31, 2010, the Company owned approximately \$11.14 million and \$12.24 million, respectively, in FHLBA stock, which is classified as other assets. The Company's policy is to review for impairment of such assets at the end of each reporting period. Based on the Company's review of publicly available information about the FHLBA and its own internal analysis, the Company believes that its FHLBA stock was not impaired as of September 30, 2011.

**Note 4. Loans**

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

| <i>(Dollars in Thousands)</i>           | September 30, 2011  |                | December 31, 2010   |                |
|---|---------------------|----------------|---------------------|----------------|
|   | Amount              | Percent        | Amount              | Percent        |
| <b>Commercial loans</b>                 |                     |                |                     |                |
| Construction commercial                 | \$ 32,279           | 2.35%          | \$ 42,694           | 3.08%          |
| Land development                        | 3,304               | 0.24%          | 16,650              | 1.20%          |
| Other land loans                        | 23,001              | 1.67%          | 24,468              | 1.77%          |
| Commercial and industrial               | 92,894              | 6.76%          | 94,123              | 6.79%          |
| Single family residential               | 107,879             | 7.85%          | N/A                 | N/A            |
| Multi-family residential                | 82,939              | 6.03%          | 67,824              | 4.89%          |
| Non-farm, non-residential               | 325,830             | 23.70%         | 351,904             | 25.39%         |
| Agricultural                            | 1,570               | 0.12%          | 1,342               | 0.10%          |
| Farmland                                | 36,605              | 2.66%          | 36,954              | 2.67%          |
| <b>Total commercial loans</b>           | <b>706,301</b>      | <b>51.38%</b>  | <b>635,959</b>      | <b>45.89%</b>  |
| <b>Consumer real estate loans</b>       |                     |                |                     |                |
| Home equity lines                       | 109,444             | 7.96%          | 111,620             | 8.05%          |
| Single family residential mortgage      | 461,104             | 33.54%         | 549,157             | 39.61%         |
| Owner-occupied construction             | 19,279              | 1.40%          | 18,349              | 1.32%          |
| <b>Total consumer real estate loans</b> | <b>589,827</b>      | <b>42.90%</b>  | <b>679,126</b>      | <b>48.98%</b>  |
| <b>Consumer and other loans</b>         |                     |                |                     |                |
| Consumer loans                          | 67,020              | 4.88%          | 63,475              | 4.58%          |
| Other                                   | 11,508              | 0.84%          | 7,646               | 0.55%          |
| <b>Total consumer and other loans</b>   | <b>78,528</b>       | <b>5.72%</b>   | <b>71,121</b>       | <b>5.13%</b>   |
| <b>Total loans</b>                      | <b>\$ 1,374,656</b> | <b>100.00%</b> | <b>\$ 1,386,206</b> | <b>100.00%</b> |
| Loans held for sale                     | \$ 3,575            |                | \$ 4,694            |                |

During the third quarter of 2011, the Company enhanced its loan loss methodology by further segmenting the one-to-four family residential real estate class into owner occupied and non-owner occupied segments. The enhancement in the one-to-four family residential real estate class resulted in the owner occupied portion being reported in the consumer real estate loan segment and the non-owner occupied portion being reported in the commercial loans segment.

*Acquired, Impaired Loans*

Loans acquired in a business combination are recorded at estimated fair value on their purchase date. Under applicable accounting standards, it is not appropriate to carryover a valuation for allowance for loan losses at the time of acquisition when the acquired loans have evidence of credit deterioration. Evidence of credit quality deterioration as of the purchase date may include measures such as credit scores, decline in collateral value, past due and non-accrual status. For acquired, impaired loans the difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference which is included in the carrying amount of the loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reversal of the nonaccretable difference with a positive impact on interest income prospectively. Further, any excess of cash flows expected at acquisition over the estimated

fair value is referred to as the accretable yield and is recognized in interest income over the remaining life

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of the loan when there is a reasonable expectation about the amount and timing of such cash flows. Acquired performing loans are recorded at fair value, including a credit component. The fair value adjustment is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. A provision for loan losses is recorded for any credit deterioration in these loans subsequent to acquisition.

The following table presents information regarding acquired, impaired loans for the three- and nine-month periods ended September 30, 2011 and 2010. The Company has estimated the cash flows to be collected on the loans and discounted those cash flows at a market rate of interest.

| <i>(In thousands)</i>       | Acquired, Impaired Loans |               |          |          |               |          |
|-----------------------------|--------------------------|---------------|----------|----------|---------------|----------|
|                             | TriStone                 | 2011<br>Other | Total    | TriStone | 2010<br>Other | Total    |
| Balance, January 1          | \$ 2,814                 | \$ 407        | \$ 3,221 | \$ 3,838 | \$ 4,196      | \$ 8,034 |
| Principal payments received | (482)                    |               | (482)    | (997)    | (224)         | (1,221)  |
| Accretion                   | 122                      |               | 122      | 46       |               | 46       |
| Other                       | 4                        |               | 4        | 463      |               | 463      |
| Charge-offs                 |                          |               |          | (499)    |               | (499)    |
| Balance, September 30       | \$ 2,458                 | \$ 407        | \$ 2,865 | \$ 2,851 | \$ 3,972      | \$ 6,823 |
| Balance, June 30            | \$ 2,714                 | \$ 407        | \$ 3,121 | \$ 2,834 | \$ 3,972      | \$ 6,806 |
| Principal payments received | (309)                    |               | (309)    | (36)     |               | (36)     |
| Accretion                   | 53                       |               | 53       | 16       |               | 16       |
| Other                       |                          |               |          | 37       |               | 37       |
| Charge-offs                 |                          |               |          |          |               |          |
| Balance, September 30       | \$ 2,458                 | \$ 407        | \$ 2,865 | \$ 2,851 | \$ 3,972      | \$ 6,823 |

The remaining balance of the accretable difference at September 30, 2011, and December 31, 2010, was \$822 thousand and \$944 thousand, respectively.

*Off-Balance Sheet Financial Instruments*

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

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

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

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Financial instruments whose contract amounts represent credit risk are commitments to extend credit (including availability of lines of credit) of \$206.98 million and standby letters of credit and financial guarantees written of \$2.90 million at September 30, 2011. Additionally, the Company had gross notional amounts of outstanding commitments to lend related to secondary market mortgage loans of \$10.42 million at September 30, 2011.

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### **Note 5. Allowance for Loan Losses and Credit Quality**

The allowance for loan losses is maintained at a level that the Company believes is 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. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

Management performs quarterly assessments to determine the appropriate level of allowance for loan losses. Differences between actual loan loss experience and estimates are reflected through adjustments that are made by either increasing or decreasing the allowance based upon current measurement criteria. Commercial, consumer real estate, and non-real estate consumer 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 that have been deemed impaired. Management's general reserve 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. The allowance methodology was recently enhanced to further segment the commercial loan portfolio by risk grade. Historical loss rates for each risk grade of commercial loans are adjusted by environmental factors to estimate the amount of reserve needed by segment. 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 Company enhanced its allowance for loan loss methodology during the first quarter of 2011. The enhancement included, among other things, further segmentation of the commercial loan portfolio by risk code and consideration of additional qualitative factors as outlined in the Interagency Policy Statement for Loan and Lease Losses. Under the previous methodology, qualitative adjustments were a multiple of the historical loss rate calculated by the Company for each segment, as compared to the enhanced methodology that utilizes addition to and subtraction from the historical loss rate.

Initially, the qualitative factors for the consumer loan segments under the enhanced methodology were calculated by determining an equivalent rate to the prior method. As part of the continued refinement of the enhanced methodology, the adjustments historically applied to consumer loans were reviewed. As of the third quarter of 2011, it was determined that qualitative adjustments to the consumer loan segments' loss rates should be revised downward based upon review and analysis of historical loss experience within the portfolio as the Company is now estimating fewer losses on the consumer portfolio. As a result of the downward revision, the allocation of the allowance to the consumer loan segments is 30%. Historically, net consumer charge-offs comprised 28% of total net charge-offs. The decrease in estimated losses on the consumer portfolio segment was offset by increases in estimated losses on the commercial portfolio segment. The increase is particularly in specific loss estimated on certain impaired loans as a result of new information regarding the values of underlying collateral.

As an additional enhancement to the loan loss methodology in the third quarter of 2011, the Company further segmented the one-to-four family residential real estate class into owner occupied and non-owner occupied segments, which management believes provides better granularity and segmentation of loans with similar risk characteristics. This also contributed to the overall reduction of estimated losses on non-impaired consumer loan segments in the allowance model, as losses on the Company's non-owner occupied residential real estate loans have historically been higher than losses on owner occupied residential real estate loans. The following tables reflect the change of the segmentation in the single family residential loan class for the period ended September 30, 2011.

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The following tables detail the Company's allowance for loan loss activity, by portfolio segment, for the three- and nine-month periods ended September 30, 2011 and 2010.

| <i>(In Thousands)</i>            | For the Three Months Ended September 30, 2011 |                      |                    |           |
|----------------------------------|---|----------------------|--------------------|-----------|
|                                  | Commercial                                    | Consumer Real Estate | Consumer and Other | Total     |
| Allowance for credit losses:     |   |                      |                    |           |
| Beginning balance                | \$ 12,300                                     | \$ 12,641            | \$ 1,541           | \$ 26,482 |
| Provision for loan losses        | 7,393   | (4,811)              | (662)              | 1,920     |
| Loans charged off                | (2,157)                                       | (712)                | (193)              | (3,062)   |
| Recoveries credited to allowance | 968   | 15                   | 84                 | 1,067     |
| Net charge-offs                  | (1,189)                                       | (697)                | (109)              | (1,995)   |
| Ending balance                   | \$ 18,504                                     | \$ 7,133             | \$ 770             | \$ 26,407 |

| <i>(In Thousands)</i>            | For the Three Months Ended September 30, 2010 |                      |                    |           |
|----------------------------------|---|----------------------|--------------------|-----------|
|                                  | Commercial                                    | Consumer Real Estate | Consumer and Other | Total     |
| Allowance for credit losses:     |   |                      |                    |           |
| Beginning balance                | \$ 13,649                                     | \$ 9,157             | \$ 2,205           | \$ 25,011 |
| Provision for loan losses        | 1,853   | 1,667                | 290                | 3,810     |
| Loans charged off                | (1,994)                                       | (342)                | (315)              | (2,651)   |
| Recoveries credited to allowance | 110   | 16                   | 124                | 250       |
| Net charge-offs                  | (1,884)                                       | (326)                | (191)              | (2,401)   |
| Ending balance                   | \$ 13,618                                     | \$ 10,498            | \$ 2,304           | \$ 26,420 |

| <i>(In Thousands)</i>            | For the Nine Months Ended September 30, 2011 |                      |                    |           |
|----------------------------------|--|----------------------|--------------------|-----------|
|                                  | Commercial                                   | Consumer Real Estate | Consumer and Other | Total     |
| Allowance for credit losses:     |  |                      |                    |           |
| Beginning balance                | \$ 12,300                                    | \$ 12,641            | \$ 1,541           | \$ 26,482 |
| Provision for loan losses        | 10,258                                       | (3,190)              | (457)              | 6,611     |
| Loans charged off                | (5,324)                                      | (2,541)              | (680)              | (8,545)   |
| Recoveries credited to allowance | 1,270  | 223                  | 366                | 1,859     |
| Net charge-offs                  | (4,054)                                      | (2,318)              | (314)              | (6,686)   |
| Ending balance                   | \$ 18,504                                    | \$ 7,133             | \$ 770             | \$ 26,407 |

| <i>(In Thousands)</i>        | For the Nine Months Ended September 30, 2010 |                      |                    |           |
|------------------------------|--|----------------------|--------------------|-----------|
|                              | Commercial                                   | Consumer Real Estate | Consumer and Other | Total     |
| Allowance for credit losses: |  |                      |                    |           |
| Beginning balance            | \$ 13,802                                    | \$ 8,457             | \$ 2,018           | \$ 24,277 |
| Provision for loan losses    | 5,936  | 4,249                | 886                | 11,071    |
| Loans charged off            | (6,577)                                      | (2,260)              | (919)              | (9,756)   |

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|                                  |           |           |          |           |
|----------------------------------|-----------|-----------|----------|-----------|
| Recoveries credited to allowance | 457       | 52        | 319      | 828       |
| Net charge-offs                  | (6,120)   | (2,208)   | (600)    | (8,928)   |
| Ending balance                   | \$ 13,618 | \$ 10,498 | \$ 2,304 | \$ 26,420 |

The Company identifies loans for potential impairment through a variety of means including, but not limited to, ongoing loan review, renewal processes, delinquency data, market communications, and public information. If it is determined that it is probable that the Company will not collect all principal and interest amounts contractually due, the loan is generally deemed to be impaired.

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The following table presents the Company's recorded investment in loans considered to be impaired and related information on those impaired loans for the periods ended September 30, 2011, and December 31, 2010.

|  | September 30, 2011  |                   |                          |                             |                            |                             |                            |
|--|---------------------|-------------------|--------------------------|-----------------------------|----------------------------|-----------------------------|----------------------------|
|  | Recorded Investment | Related Allowance | Unpaid Principal Balance | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| <i>(Amounts in Thousands)</i>            |                     |                   |                          |                             |                            |                             |                            |
| <b>Loans without a related allowance</b> |                     |                   |                          |                             |                            |                             |                            |
| Commercial loans                         |                     |                   |                          |                             |                            |                             |                            |
| Construction commercial                  | \$ 66               | \$                | \$ 70                    | \$ 73                       | \$ 1                       | \$ 76                       | \$ 4                       |
| Land development                         |                     |                   |                          |                             |                            |                             |                            |
| Other land loans                         | 68                  |                   | 68                       | 67                          |                            | 118                         | 1                          |
| Commercial and industrial                | 267                 |                   | 291                      | 314                         | 4                          | 746                         | 8                          |
| Single family residential                | 4,291               |                   | 4,385                    | 4,380                       | 23                         | 4,658                       | 68                         |
| Multi-family residential                 | 546                 |                   | 564                      | 1,059                       | 11                         | 1,150                       | 26                         |
| Non-farm, non-residential                | 2,017               |                   | 2,137                    | 2,236                       | 30                         | 2,655                       | 60                         |
| Farmland                                 | 475                 |                   | 475                      | 552                         |                            | 552                         |                            |
| Consumer real estate loans               |                     |                   |                          |                             |                            |                             |                            |
| Home equity lines                        | 940                 |                   | 978                      | 984                         | 17                         | 1,061                       | 36                         |
| Single family residential mortgage       | 6,453               |                   | 6,600                    | 7,030                       | 81                         | 7,588                       | 168                        |
| Owner-occupied construction              | 119                 |                   | 125                      | 125                         | 2                          | 126                         | 6                          |
| Consumer loans                           | 54                  |                   | 60                       | 62                          | 2                          | 66                          | 4                          |
|  | \$ 15,296           | \$                | \$ 15,753                | \$ 16,882                   | \$ 171                     | \$ 18,796                   | \$ 381                     |
| <b>Loans with a related allowance</b>    |                     |                   |                          |                             |                            |                             |                            |
| Commercial loans                         |                     |                   |                          |                             |                            |                             |                            |
| Construction commercial                  | \$ 265              | \$ 25             | \$ 268                   | \$ 268                      | \$ 2                       | \$ 269                      | \$ 2                       |
| Land development                         |                     |                   |                          |                             |                            |                             |                            |
| Other land loans                         | 112                 | 5                 | 112                      | 112                         | 1                          | 113                         | 4                          |
| Commercial and industrial                | 4,032               | 2,045             | 4,064                    | 4,041                       | 8                          | 4,066                       | 16                         |
| Single family residential                | 2,242               | 124               | 2,242                    | 2,002                       | 25                         | 2,012                       | 108                        |
| Multi-family residential                 | 591                 | 196               | 591                      | 591                         |                            | 591                         |                            |
| Non-farm, non-residential                | 6,373               | 2,153             | 6,456                    | 6,423                       | 98                         | 6,430                       | 109                        |
| Farmland                                 |                     |                   |                          |                             |                            |                             |                            |
| Consumer real estate loans               |                     |                   |                          |                             |                            |                             |                            |
| Home equity lines                        | 338                 | 200               | 339                      | 336                         |                            | 335                         |                            |
| Single family residential mortgage       | 5,969               | 1,210             | 6,048                    | 6,198                       | 51                         | 6,310                       | 114                        |
| Owner-occupied construction              |                     |                   |                          |                             |                            |                             |                            |
| Consumer loans                           |                     |                   |                          |                             |                            |                             |                            |
|  | \$ 19,922           | \$ 5,958          | \$ 20,120                | \$ 19,971                   | \$ 185                     | \$ 20,126                   | \$ 353                     |

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|  | December 31, 2010      |                      |                                |                                   |  |
|--|------------------------|----------------------|--------------------------------|-----------------------------------|--|
|  | Recorded<br>Investment | Related<br>Allowance | Unpaid<br>Principal<br>Balance | Average<br>Recorded<br>Investment | Year-to-Date<br>Interest<br>Income<br>Recognized |
| <i>(Amounts in Thousands)</i>            |                        |                      |                                |                                   |  |
| <b>Loans without a related allowance</b> |                        |                      |                                |                                   |  |
| Commercial loans                         |                        |                      |                                |                                   |  |
| Construction commercial                  | \$ 285                 | \$                   | \$ 732                         | \$ 730                            | \$ 3   |
| Land development                         | 50                     |                      | 144                            | 143                               | 2  |
| Other land loans                         | 323                    |                      | 742                            | 152                               | 13   |
| Commercial and industrial                | 3,518                  |                      | 5,384                          | 6,237                             | 10   |
| Multi-family residential                 | 2,526                  |                      | 2,673                          | 2,680                             | 105  |
| Non-farm, non-residential                | 3,824                  |                      | 4,985                          | 4,658                             | 53   |
| Consumer real estate loans               |                        |                      |                                |                                   |  |
| Home equity lines                        | 1,302                  |                      | 1,595                          | 1,605                             | 38   |
| Single family residential mortgage       | 7,992                  |                      | 10,882                         | 9,093                             | 330  |
| Owner-occupied construction              | 6                      |                      | 6                              | 6                                 |  |
| Consumer loans                           | 98                     |                      | 102                            | 11                                | 5  |
|  | \$ 19,924              | \$                   | \$ 27,245                      | \$ 25,315                         | \$ 559   |
| <b>Loans with a related allowance</b>    |                        |                      |                                |                                   |  |
| Commercial loans                         |                        |                      |                                |                                   |  |
| Construction commercial                  | \$                     | \$                   | \$                             | \$                                | \$   |
| Land development                         | 113                    | 5                    | 113                            | 114                               | 7  |
| Other land loans                         |                        |                      |                                |                                   |  |
| Commercial and industrial                |                        |                      |                                |                                   |  |
| Multi-family residential                 | 723                    | 257                  | 759                            | 768                               | 21   |
| Non-farm, non-residential                | 1,070                  | 158                  | 1,140                          | 1,151                             | 26   |
| Consumer real estate loans               |                        |                      |                                |                                   |  |
| Home equity lines                        | 95                     | 34                   | 98                             | 98                                | 2  |
| Single family residential mortgage       | 8,801                  | 1,870                | 7,548                          | 8,913                             | 310  |
| Owner-occupied construction              |                        |                      |                                |                                   |  |
| Consumer loans                           |                        |                      |                                |                                   |  |
|  | \$ 10,802              | \$ 2,324             | \$ 9,658                       | \$ 11,044                         | \$ 366   |

As part of the ongoing monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk rating of commercial loans, the level of classified commercial loans, net charge-offs, non-performing loans and general economic conditions. The Company's loan review function generally reviews all commercial loan relationships greater than \$2.00 million on an annual basis and at various times through the year. Smaller commercial and retail loans are sampled for review throughout the year by our internal loan review department. Through the loan review process, loans are identified for upgrade or downgrade in risk rating and changed to reflect current information as part of the process.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. A description of the general characteristics of the risk grades is as follows:

**Pass** This grade includes loans to borrowers of acceptable credit quality and risk. The Company further differentiates within this grade based upon borrower characteristics which include: capital strength, earnings stability, leverage, and industry.

**Special Mention** This grade includes loans that require more than a normal degree of supervision and attention. These loans have all the characteristics of an adequate asset, but due to being adversely affected by economic or financial conditions have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan.

**Substandard** This grade includes loans that have well defined weaknesses which make payment default or principal exposure possible, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment, or an event outside of the normal course of business to meet the repayment terms.

**Doubtful** This grade includes loans that are placed on non-accrual status. These loans have all the weaknesses inherent in a substandard loan with the added factor that the weaknesses are so severe that collection or liquidation in full, on the basis of current existing facts, conditions and values, is extremely unlikely, but because of certain specific pending factors, the amount of loss cannot yet be determined.

**Loss** This grade includes loans that are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. **Loss** is not intended to imply that the asset

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has no recovery or salvage value, but simply that it is not practical or desirable to defer writing off all or some portion of the loan, even though partial recovery may be effected in the future.

The following tables present the Company's investment in loans by internal credit grade indicator at September 30, 2011, and December 31, 2010.

| <i>(Amounts in Thousands)</i>      | September 30, 2011  |                    |                  |                 |           |                     |
|------------------------------------|---------------------|--------------------|------------------|-----------------|-----------|---------------------|
|                                    | Pass                | Special<br>Mention | Substandard      | Doubtful        | Loss      | Total               |
| <b>Commercial loans</b>            |                     |                    |                  |                 |           |                     |
| Construction commercial            | \$ 30,678           | \$ 412             | \$ 1,189         | \$              | \$        | \$ 32,279           |
| Land development                   | 2,879               | 250                | 175              |                 |           | 3,304               |
| Other land loans                   | 16,845              | 5,880              | 276              |                 |           | 23,001              |
| Commercial and industrial          | 87,209              | 499                | 2,759            | 2,427           |           | 92,894              |
| Single family residential          | 93,622              | 2,543              | 11,714           |                 |           | 107,879             |
| Multi-family residential           | 79,068              | 985                | 2,886            |                 |           | 82,939              |
| Non-farm, non-residential          | 294,641             | 7,695              | 23,039           | 455             |           | 325,830             |
| Agricultural                       | 1,529               |                    | 41               |                 |           | 1,570               |
| Farmland                           | 35,004              | 853                | 748              |                 |           | 36,605              |
| <b>Consumer real estate loans</b>  |                     |                    |                  |                 |           |                     |
| Home equity lines                  | 104,251             | 1,884              | 3,309            |                 |           | 109,444             |
| Single family residential mortgage | 425,091             | 7,908              | 28,105           |                 |           | 461,104             |
| Owner-occupied construction        | 18,619              | 130                | 530              |                 |           | 19,279              |
| <b>Consumer and other loans</b>    |                     |                    |                  |                 |           |                     |
| Consumer loans                     | 66,277              | 174                | 569              |                 |           | 67,020              |
| Other                              | 11,497              | 2                  | 9                |                 |           | 11,508              |
| <b>Total loans</b>                 | <b>\$ 1,267,210</b> | <b>\$ 29,215</b>   | <b>\$ 75,349</b> | <b>\$ 2,882</b> | <b>\$</b> | <b>\$ 1,374,656</b> |

| <i>(Amounts in Thousands)</i>      | December 31, 2010   |                    |                  |               |           |                     |
|------------------------------------|---------------------|--------------------|------------------|---------------|-----------|---------------------|
|                                    | Pass                | Special<br>Mention | Substandard      | Doubtful      | Loss      | Total               |
| <b>Commercial loans</b>            |                     |                    |                  |               |           |                     |
| Construction commercial            | \$ 40,497           | \$ 663             | \$ 1,534         | \$            | \$        | \$ 42,694           |
| Land development                   | 14,458              | 1,226              | 966              |               |           | 16,650              |
| Other land loans                   | 16,723              | 6,138              | 1,607            |               |           | 24,468              |
| Commercial and industrial          | 87,156              | 1,756              | 5,211            |               |           | 94,123              |
| Multi-family residential           | 61,059              | 2,553              | 4,212            |               |           | 67,824              |
| Non-farm, non-residential          | 316,026             | 18,942             | 16,936           |               |           | 351,904             |
| Agricultural                       | 1,318               |                    | 24               |               |           | 1,342               |
| Farmland                           | 33,042              | 2,569              | 1,343            |               |           | 36,954              |
| <b>Consumer real estate loans</b>  |                     |                    |                  |               |           |                     |
| Home equity lines                  | 106,803             | 1,923              | 2,894            |               |           | 111,620             |
| Single family residential mortgage | 498,830             | 15,224             | 34,449           | 654           |           | 549,157             |
| Owner-occupied construction        | 17,389              | 789                | 171              |               |           | 18,349              |
| <b>Consumer and other loans</b>    |                     |                    |                  |               |           |                     |
| Consumer loans                     | 62,676              | 306                | 493              |               |           | 63,475              |
| Other                              | 7,635               | 11                 |                  |               |           | 7,646               |
| <b>Total loans</b>                 | <b>\$ 1,263,612</b> | <b>\$ 52,100</b>   | <b>\$ 69,840</b> | <b>\$ 654</b> | <b>\$</b> | <b>\$ 1,386,206</b> |

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The following tables detail the Company's recorded investment in loans related to each segment in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology at September 30, 2011, and December 31, 2010.

|   | September 30, 2011                          |  |   |  |   |  |
|---|---|--|---|--|---|--|
|   | Loans Individually Evaluated for Impairment | Allowance for Loans Individually Evaluated | Loans Collectively Evaluated for Impairment | Allowance for Loans Collectively Evaluated | Acquired, Impaired Loans Evaluated for Impairment | Allowance for Acquired, Impaired Loans Evaluated |
| <i>(Amounts in Thousands)</i>           |   |  |   |  |   |  |
| <b>Commercial loans</b>                 |   |  |   |  |   |  |
| Construction commercial                 | \$ 331                                      | \$ 25                                      | \$ 31,948                                   | \$ 944                                     | \$  | \$   |
| Land development                        |   |  | 3,304                                       | 273  |   |  |
| Other land loans                        | 180   | 5  | 22,672                                      | 555  | 149   |  |
| Commercial and industrial               | 4,299                                       | 2,045                                      | 87,965                                      | 1,969                                      | 630   |  |
| Single family residential               | 6,533                                       | 124  | 100,096                                     | 2,791                                      | 1,250   |  |
| Multi-family residential                | 1,137                                       | 196  | 81,802                                      | 2,069                                      |   |  |
| Non-farm, non-residential               | 8,390                                       | 2,153                                      | 316,986                                     | 4,931                                      | 454   |  |
| Agricultural                            |   |  | 1,570                                       | 25   |   |  |
| Farmland                                | 475   |  | 36,130                                      | 399  |   |  |
| <b>Total commercial loans</b>           | <b>21,345</b>                               | <b>4,548</b>                               | <b>682,473</b>                              | <b>13,956</b>                              | <b>2,483</b>                                      |  |
| <b>Consumer real estate loans</b>       |   |  |   |  |   |  |
| Home equity lines                       | 1,278                                       | 200  | 108,166                                     | 1,206                                      |   |  |
| Single family residential mortgage      | 12,422                                      | 1,210                                      | 448,297                                     | 4,320                                      | 385   |  |
| Owner-occupied construction             | 119   |  | 19,160                                      | 197  |   |  |
| <b>Total consumer real estate loans</b> | <b>13,819</b>                               | <b>1,410</b>                               | <b>575,623</b>                              | <b>5,723</b>                               | <b>385</b>  |  |
| <b>Consumer and other loans</b>         |   |  |   |  |   |  |
| Consumer loans                          | 54  |  | 66,966                                      | 770  |   |  |
| Other                                   |   |  | 11,508                                      |  |   |  |
| <b>Total consumer and other loans</b>   | <b>54</b>                                   |  | <b>78,474</b>                               | <b>770</b>                                 |   |  |
| <b>Total loans</b>                      | <b>\$ 35,218</b>                            | <b>\$ 5,958</b>                            | <b>\$ 1,336,570</b>                         | <b>\$ 20,449</b>                           | <b>\$ 2,868</b>                                   | <b>\$</b>  |

|                                   | December 31, 2010                           |  |   |  |   |  |
|-----------------------------------|---|--|---|--|---|--|
|                                   | Loans Individually Evaluated for Impairment | Allowance for Loans Individually Evaluated | Loans Collectively Evaluated for Impairment | Allowance for Loans Collectively Evaluated | Acquired, Impaired Loans Evaluated for Impairment | Allowance for Acquired, Impaired Loans Evaluated |
| <i>(Amounts in Thousands)</i>     |   |  |   |  |   |  |
| <b>Commercial loans</b>           |   |  |   |  |   |  |
| Construction commercial           | \$ 285                                      | \$   | \$ 42,409                                   | \$ 1,472                                   | \$  | \$   |
| Land development                  | 50  | 5  | 16,600                                      | 1,767                                      |   |  |
| Other land loans                  | 436   |  | 23,520                                      | 747  | 512   |  |
| Commercial and industrial         | 3,518                                       |  | 90,084                                      | 4,511                                      | 521   |  |
| Multi-family residential          | 3,249                                       | 257  | 64,575                                      | 824  |   |  |
| Non-farm, non-residential         | 4,894                                       | 158  | 346,586                                     | 2,688                                      | 424   |  |
| Agricultural                      |   |  | 1,342                                       | 19   |   |  |
| Farmland                          |   |  | 36,954                                      | 70   |   |  |
| <b>Total commercial loans</b>     | <b>12,432</b>                               | <b>420</b>                                 | <b>622,070</b>                              | <b>12,098</b>                              | <b>1,457</b>                                      |  |
| <b>Consumer real estate loans</b> |   |  |   |  |   |  |
| Home equity lines                 | 1,397                                       | 34   | 110,223                                     | 2,104                                      |   |  |

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|   |                  |                 |                     |                  |                 |
|---|------------------|-----------------|---------------------|------------------|-----------------|
| Single family residential mortgage      | 16,793           | 1,870           | 530,600             | 7,999            | 1,764           |
| Owner-occupied construction             | 6                |                 | 18,343              | 193              |                 |
| <b>Total consumer real estate loans</b> | <b>18,196</b>    | <b>1,904</b>    | <b>659,166</b>      | <b>10,296</b>    | <b>1,764</b>    |
| Consumer and other loans                |                  |                 |                     |                  |                 |
| Consumer loans                          | 98               |                 | 63,377              | 1,764            |                 |
| Other                                   |                  |                 | 7,646               |                  |                 |
| <b>Total consumer and other loans</b>   | <b>98</b>        |                 | <b>71,023</b>       | <b>1,764</b>     |                 |
| <b>Total loans</b>                      | <b>\$ 30,726</b> | <b>\$ 2,324</b> | <b>\$ 1,352,259</b> | <b>\$ 24,158</b> | <b>\$ 3,221</b> |

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**Table of Contents***Non-accrual and Past Due Loans*

Non-accrual loans, presented by loan class, consisted of the following at September 30, 2011, and December 31, 2010:

| <i>(Amounts in Thousands)</i>      | September 30,<br>2011 | December 31,<br>2010 |
|------------------------------------|-----------------------|----------------------|
| Commercial loans                   |                       |                      |
| Construction commercial            | \$ 331                | \$ 285               |
| Land development                   |                       | 50                   |
| Other land loans                   | 68                    | 321                  |
| Commercial and industrial          | 3,892                 | 3,518                |
| Single family residential          | 4,011                 | N/A                  |
| Multi-family residential           | 1,138                 | 2,463                |
| Non-farm, non-residential          | 7,935                 | 4,670                |
| Farmland                           | 475                   |                      |
| Consumer real estate loans         |                       |                      |
| Home equity lines                  | 886                   | 868                  |
| Single family residential mortgage | 3,561                 | 6,364                |
| Owner-occupied construction        | 119                   | 6                    |
| Consumer and other loans           |                       |                      |
| Consumer loans                     | 54                    | 99                   |
| <b>Total</b>                       | <b>22,470</b>         | <b>18,644</b>        |
| Acquired, impaired loans           | 407                   | 770                  |
| <b>Total non-accrual loans</b>     | <b>\$ 22,877</b>      | <b>\$ 19,414</b>     |

The following tables present the aging of the recorded investment in past due loans, by loan class, as of September 30, 2011, and December 31, 2010. There were no loans past due 90 days and still accruing interest at September 30, 2011, or December 31, 2010. Non-accrual loans, excluding those 0 to 29 days past due, are included in the applicable delinquency category.

| <i>(Amounts in Thousands)</i>      | September 30, 2011 |             |          |                   | Current<br>Loans | Total<br>Loans |
|------------------------------------|--------------------|-------------|----------|-------------------|------------------|----------------|
|                                    | 30 -59 Days        | 60 -89 Days | 90+ Days | Total<br>Past Due |                  |                |
| Commercial loans                   |                    |             |          |                   |                  |                |
| Construction commercial            | \$ 1,059           | \$          | \$ 11    | \$ 1,070          | \$ 31,209        | \$ 32,279      |
| Land development                   |                    | 46          |          | 46                | 3,258            | 3,304          |
| Other land loans                   |                    |             | 68       | 68                | 22,933           | 23,001         |
| Commercial and industrial          | 343                |             | 3,539    | 3,882             | 89,012           | 92,894         |
| Single family residential          | 1,456              | 412         | 2,946    | 4,814             | 103,065          | 107,879        |
| Multi-family residential           | 63                 | 452         | 1,138    | 1,653             | 81,286           | 82,939         |
| Non-farm, non-residential          | 776                | 439         | 5,996    | 7,211             | 318,619          | 325,830        |
| Agricultural                       | 31                 |             |          | 31                | 1,539            | 1,570          |
| Farmland                           | 137                |             | 475      | 612               | 35,993           | 36,605         |
| Consumer real estate loans         |                    |             |          |                   |                  |                |
| Home equity lines                  | 805                | 147         | 563      | 1,515             | 107,929          | 109,444        |
| Single family residential mortgage | 2,345              | 1,985       | 1,859    | 6,189             | 454,915          | 461,104        |
| Owner-occupied construction        | 2                  |             |          | 2                 | 19,277           | 19,279         |
| Consumer and other loans           |                    |             |          |                   |                  |                |
| Consumer loans                     | 171                | 28          | 10       | 209               | 66,811           | 67,020         |
| Other                              |                    |             |          |                   | 11,508           | 11,508         |

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|             |          |          |           |           |              |              |
|-------------|----------|----------|-----------|-----------|--------------|--------------|
| Total loans | \$ 7,188 | \$ 3,509 | \$ 16,605 | \$ 27,302 | \$ 1,347,354 | \$ 1,374,656 |
|-------------|----------|----------|-----------|-----------|--------------|--------------|

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| (Amounts in Thousands)             | December 31, 2010 |                 |                  |                  |                     |                     |
|------------------------------------|-------------------|-----------------|------------------|------------------|---------------------|---------------------|
|                                    | 30 -59 Days       | 60 -89 Days     | 90+ Days         | Total Past Due   | Current Loans       | Total Loans         |
| Commercial loans                   |                   |                 |                  |                  |                     |                     |
| Construction commercial            | \$ 531            | \$              | \$ 122           | \$ 653           | \$ 42,041           | \$ 42,694           |
| Land development                   |                   |                 | 50               | 50               | 16,600              | 16,650              |
| Other land loans                   |                   |                 | 684              | 684              | 23,784              | 24,468              |
| Commercial and industrial          | 3,648             | 121             | 356              | 4,125            | 89,998              | 94,123              |
| Multi-family residential           | 956               |                 | 1,793            | 2,749            | 65,075              | 67,824              |
| Non-farm, non-residential          | 3,251             | 2,056           | 3,249            | 8,556            | 343,348             | 351,904             |
| Agricultural                       | 19                |                 |                  | 19               | 1,323               | 1,342               |
| Farmland                           | 110               |                 |                  | 110              | 36,844              | 36,954              |
| Consumer real estate loans         |                   |                 |                  |                  |                     |                     |
| Home equity lines                  | 682               | 250             | 608              | 1,540            | 110,080             | 111,620             |
| Single family residential mortgage | 10,287            | 1,741           | 4,213            | 16,241           | 532,916             | 549,157             |
| Owner-occupied construction        | 855               | 326             | 6                | 1,187            | 17,162              | 18,349              |
| Consumer and other loans           |                   |                 |                  |                  |                     |                     |
| Consumer loans                     | 433               | 47              | 31               | 511              | 62,964              | 63,475              |
| Other                              |                   |                 |                  |                  | 7,646               | 7,646               |
| <b>Total loans</b>                 | <b>\$ 20,772</b>  | <b>\$ 4,541</b> | <b>\$ 11,112</b> | <b>\$ 36,425</b> | <b>\$ 1,349,781</b> | <b>\$ 1,386,206</b> |

*Troubled Debt Restructurings*

At September 30, 2011, the allowance for loan losses related to total loan restructurings was \$959 thousand. Total interest income recognized on loan restructurings for the three- and nine- month periods ended September 30, 2011, totaled \$173 thousand and \$428 thousand, respectively.

When restructuring loans for troubled borrowers, the Company generally makes concessions in interest rates, loan terms and/or amortization terms. All restructured loans to troubled borrowers in excess of \$250 thousand are evaluated for a specific reserve based on the net present value method. Restructured loans under \$250 thousand are subject to the reserve calculation at the historical loss rate for classified loans.

There were no loans modified as troubled debt restructurings within the previous 12 months for which there was a payment default for the three- and nine-month periods ended September 30, 2011. The Company's review of loan modifications beginning January 1, 2011, did not identify any new troubled debt restructurings resulting from the adoption of the guidance outlined in ASU 2011-02.

For the three- and nine-month periods ended September 30, 2011, the following table presents a breakdown of the types of concessions made by loan class.

|  | For the Three Months ended September 30, 2011 |  |   | For the Nine Months ended September 30, 2011 |  |   |
|--|---|--|---|--|--|---|
|  | Number of loans                               | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of loans                              | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| <b>Below market interest rate</b>                            |   |  |   |  |  |   |
| Single family residential mortgage                           | 1   | \$ 70,524  | \$ 70,524   | 1  | \$ 70,524  | \$ 70,524   |
| <b>Below market interest rate and extended payment terms</b> |   |  |   |  |  |   |
| Non-farm, non-residential                                    |   |  |   | 2  | 106,682  | 106,682   |
| Single family residential mortgage                           | 1   | 86,689   | 86,689  | 4  | 542,198  | 542,198   |
| <b>Total</b>   | <b>1</b>                                      | <b>86,689</b>                                    | <b>86,689</b>                                     | <b>6</b>                                     | <b>648,880</b>                                   | <b>648,880</b>                                    |
| <b>Total loan concessions</b>                                | <b>2</b>                                      | <b>\$ 157,213</b>                                | <b>\$ 157,213</b>                                 | <b>7</b>                                     | <b>\$ 719,404</b>                                | <b>\$ 719,404</b>                                 |



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The following table presents the successes and failures of the types of modification within the previous 12 months as of September 30, 2011.

|   | Paid in Full    |                     | Paying as Restructured |                     |
|---|-----------------|---------------------|------------------------|---------------------|
|   | Number of loans | Recorded Investment | Number of loans        | Recorded Investment |
| Below market interest rate                            | 1               | \$                  | 1                      | \$ 70,523           |
| Below market interest rate and extended payment terms |                 |                     | 7                      | 1,685,722           |
| <b>Total</b>  | <b>1</b>        | <b>\$</b>           | <b>8</b>               | <b>\$ 1,756,245</b> |

|   | Converted to Non-accrual |                     | Foreclosure/Default |                     |
|---|--------------------------|---------------------|---------------------|---------------------|
|   | Number of loans          | Recorded Investment | Number of loans     | Recorded Investment |
| Below market interest rate                            |                          | \$                  |                     | \$                  |
| Below market interest rate and extended payment terms |                          |                     |                     |                     |
| <b>Total</b>  |                          | <b>\$</b>           |                     | <b>\$</b>           |

**Note 6. Deposits**

The following is a summary of interest-bearing deposits by type as of September 30, 2011, and December 31, 2010.

| <i>(In Thousands)</i>                                      | <b>September 30, 2011</b> | <b>December 31, 2010</b> |
|--|---------------------------|--------------------------|
| Interest-bearing demand deposits                           | \$ 295,804                | \$ 262,420               |
| Savings and money market deposits                          | 396,767                   | 426,547                  |
| Certificates of deposit and individual retirement accounts | 664,237                   | 726,837                  |
| <b>Total</b>   | <b>\$ 1,356,808</b>       | <b>\$ 1,415,804</b>      |

**Note 7. Borrowings**

The following schedule details the Company's indebtedness at September 30, 2011, and December 31, 2010.

| <i>(In Thousands)</i>                          | <b>September 30, 2011</b> | <b>December 31, 2010</b> |
|--|---------------------------|--------------------------|
| Securities sold under agreements to repurchase | \$ 139,510                | \$ 140,894               |
| FHLB borrowings                                | 150,000                   | 175,000                  |
| Subordinated debt                              | 15,464                    | 15,464                   |
| Other long-term debt                           | 477                       | 729                      |
| <b>Total</b>                                   | <b>\$ 305,451</b>         | <b>\$ 332,087</b>        |

Securities sold under agreements to repurchase consist of \$89.51 million and \$90.89 million of retail overnight and term repurchase agreements at September 30, 2011, and December 31, 2010, respectively, and \$50.00 million of wholesale repurchase agreements at both September 30, 2011, and December 31, 2010.

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The Company had a derivative interest rate swap instrument where it received LIBOR-based variable interest payments and paid fixed interest payments which expired in January 2011. The instrument effectively fixed \$50.00 million of FHLB borrowings at 4.34% for a period of five years. For a more detailed discussion of activities regarding derivatives, please see Note 13 to the Consolidated Financial Statements.

FHLB borrowings included \$150.00 million in convertible and callable advances at September 30, 2011, and \$175.00 million at December 31, 2010. During the first quarter of 2011, the Company prepaid a \$25.00 million FHLB advance. The weighted average interest rate of all the advances was 4.12% at September 30, 2011, and 2.39% at December 31, 2010.

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At September 30, 2011, the FHLB advances have approximate contractual maturities between five and ten years. The scheduled maturities of the advances are as follows:

| <i>(In Thousands)</i> | <b>Amount</b>     |
|-----------------------|-------------------|
| 2011                  | \$                |
| 2012                  |                   |
| 2013                  |                   |
| 2014                  |                   |
| 2015                  |                   |
| 2016 and thereafter   | 150,000           |
| <b>Total</b>          | <b>\$ 150,000</b> |

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 or converted to another FHLB credit product. Prepayment of the advances may result in substantial penalties based upon the differential between contractual note rates and current advance rates for similar maturities. At September 30, 2011, advances from the FHLB were secured by qualifying loans of \$337.29 million.

Also included in other indebtedness is \$15.46 million of junior subordinated debentures (the *Debentures*) issued by the Company in October 2003 to an unconsolidated trust subsidiary, FCBI Capital Trust (the *Trust*), with an interest rate of three-month LIBOR plus 2.95%. The Trust was able to purchase the Debentures through the issuance of trust preferred securities which had substantially identical terms as the Debentures. The Debentures mature on October 8, 2033, and are currently callable. The Company's obligations under the Debentures and other relevant Trust agreements, in aggregate, constitute a full and unconditional guarantee by the Company of the Trust's obligations.

**Note 8. Net Periodic Benefit Cost-Defined Benefit Plans**

The following sets forth the components of the net periodic benefit cost of the Company's domestic non-contributory, non-qualified defined executive retention plan for the three- and nine-month periods ended September 30, 2011 and 2010.

| <i>(In Thousands)</i>    | <b>For the Three Months<br/>Ended September 30,</b> |               | <b>For the Nine Months<br/>Ended September 30,</b> |               |
|--------------------------|---|---------------|--|---------------|
|                          | <b>2011</b>   | <b>2010</b>   | <b>2011</b>  | <b>2010</b>   |
| Service cost             | \$ 74   | \$ 54         | \$ 220   | \$ 159        |
| Interest cost            | 57  | 53            | 168  | 158           |
| <b>Net periodic cost</b> | <b>\$ 131</b>                                       | <b>\$ 107</b> | <b>\$ 388</b>                                      | <b>\$ 317</b> |

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The following sets forth the components of the net periodic benefit cost of the Company's domestic non-contributory, non-qualified directors retirement plan, which was effective as of January 1, 2011, for the three- and nine-month periods ended September 30, 2011.

| <i>(In Thousands)</i>    | <b>For the Three Months<br/>Ended<br/>September 30,<br/>2011</b> | <b>For the Nine Months<br/>Ended September 30,<br/>2011</b> |
|--------------------------|--|---|
| Service cost             | \$ 29  | \$ 87   |
| Interest cost            | 11   | 33  |
| <b>Net periodic cost</b> | <b>\$ 40</b>   | <b>\$ 120</b>   |

**Note 9. Comprehensive Income**

The components of the Company's comprehensive income, net of deferred income taxes, for the three- and nine-month periods ended September 30, 2011 and 2010, are as follows:

| <i>(In Thousands)</i>  | <b>For the Three Months<br/>Ended September 30,<br/>2011</b> | <b>2010</b>     | <b>For the Nine Months<br/>Ended September 30,<br/>2011</b> | <b>2010</b>      |
|--|--|-----------------|---|------------------|
| Net income   | \$ 5,318   | \$ 6,553        | \$ 16,797   | \$ 16,962        |
| Other comprehensive (loss) income  |  |                 |   |                  |
| Unrealized (loss) gain on securities available-for-sale with other-than-temporary impairment           | (657)  | 937             | (678)   | 940              |
| Unrealized (loss) gain on securities available-for-sale without other-than-temporary impairment        | (611)  | 2,900           | 11,868  | 16,220           |
| Reclassification adjustment for gains realized in net income   | (178)  | (2,574)         | (5,238)   | (4,025)          |
| Reclassification adjustment for credit related other-than-temporary impairments recognized in earnings | 210  |                 | 737   | 185              |
| Unrealized gain on derivative contract   |  | 489             | 30  | 1,509            |
| Income tax effect  | 460  | (653)           | (2,503)   | (5,524)          |
| <b>Total other comprehensive (loss) income</b>   | <b>(776)</b>   | <b>1,100</b>    | <b>4,216</b>  | <b>9,305</b>     |
| <b>Comprehensive income</b>  | <b>\$ 4,542</b>  | <b>\$ 7,653</b> | <b>\$ 21,013</b>  | <b>\$ 26,267</b> |

**Note 10. Commitments and Contingencies**

In the normal course of business, the Company is a defendant in various legal actions and asserted claims. While the Company and its legal counsel are unable to assess the ultimate outcome of each of these matters with certainty, the Company believes 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 11. Segment Information**

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



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The following table sets forth information about the reportable operating segments and reconciliation of this information to the consolidated financial statements at and for the three- and nine-month periods ended September 30, 2011 and 2010.

|  | Community<br>Banking | For the Three Months<br>Ended September 30, 2011 |                        | Total        |
|--|----------------------|--|------------------------|--------------|
|  |                      | Insurance<br>Services                            | Parent/<br>Elimination |              |
| <i>(In Thousands)</i>                        |                      |  |                        |              |
| Net interest income (expense)                | \$ 17,824            | \$ (18)  | \$ (72)                | \$ 17,734    |
| Provision for loan losses                    | 1,920                |  |                        | 1,920        |
| Noninterest income (loss)                    | 6,513                | 1,579  | (26)                   | 8,066        |
| Noninterest expense (income)                 | 14,929               | 1,286  | (155)                  | 16,060       |
| Income before income taxes                   | 7,488                | 275  | 57                     | 7,820        |
| Provision for income taxes                   | 2,370                | 109  | 23                     | 2,502        |
| Net income                                   | 5,118                | 166  | 34                     | 5,318        |
| Preferred dividend                           |                      |  | 286                    | 286          |
| Net income (loss) to common shareholders     | \$ 5,118             | \$ 166   | \$ (252)               | \$ 5,032     |
| End of period goodwill and other intangibles | \$ 78,157            | \$ 10,251  | \$                     | \$ 88,408    |
| End of period assets                         | \$ 2,200,482         | \$ 13,179  | \$ 6,431               | \$ 2,220,092 |

|  | Community<br>Banking | For the Nine Months<br>Ended September 30, 2011 |                        | Total        |
|--|----------------------|---|------------------------|--------------|
|  |                      | Insurance<br>Services                           | Parent/<br>Elimination |              |
| <i>(In Thousands)</i>                        |                      |   |                        |              |
| Net interest income (expense)                | \$ 54,034            | \$ (87)   | \$ (184)               | \$ 53,763    |
| Provision for loan losses                    | 6,611                |   |                        | 6,611        |
| Noninterest income (loss)                    | 24,237               | 5,129   | (438)                  | 28,928       |
| Noninterest expense (income)                 | 48,222               | 4,353   | (714)                  | 51,861       |
| Income before income taxes                   | 23,438               | 689   | 92                     | 24,219       |
| Provision for income taxes                   | 7,108                | 272   | 42                     | 7,422        |
| Net income                                   | 16,330               | 417   | 50                     | 16,797       |
| Preferred dividend                           |                      |   | 417                    | 417          |
| Net income (loss) to common shareholders     | \$ 16,330            | \$ 417  | \$ (367)               | \$ 16,380    |
| End of period goodwill and other intangibles | \$ 78,157            | \$ 10,251                                       | \$                     | \$ 88,408    |
| End of period assets                         | \$ 2,200,482         | \$ 13,179                                       | \$ 6,431               | \$ 2,220,092 |

For the Three Months  
Ended September 30, 2010

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|  | Community<br>Banking | Insurance<br>Services | Parent/<br>Elimination | Total        |
|--|----------------------|-----------------------|------------------------|--------------|
| <i>(In Thousands)</i>                        |                      |                       |                        |              |
| Net interest income (expense)                | \$ 18,657            | \$ (34)               | \$ (26)                | \$ 18,597    |
| Provision for loan losses                    | 3,810                |                       |                        | 3,810        |
| Noninterest income                           | 9,340                | 1,683                 | (85)                   | 10,938       |
| Noninterest expense (income)                 | 16,085               | 1,483                 | (139)                  | 17,429       |
| Income before income taxes                   | 8,102                | 166                   | 28                     | 8,296        |
| Provision for income taxes                   | 1,663                | 66                    | 14                     | 1,743        |
| Net income                                   | \$ 6,439             | \$ 100                | \$ 14                  | \$ 6,553     |
| End of period goodwill and other intangibles | \$ 78,877            | \$ 12,288             | \$                     | \$ 91,165    |
| End of period assets                         | \$ 2,278,972         | \$ 13,190             | \$ 5,263               | \$ 2,297,425 |

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|  | For the Nine Months<br>Ended September 30, 2010 |                       |                        | Total        |
|--|---|-----------------------|------------------------|--------------|
|  | Community<br>Banking                            | Insurance<br>Services | Parent/<br>Elimination |              |
| <i>(In Thousands)</i>                        |   |                       |                        |              |
| Net interest income (expense)                | \$ 55,916                                       | \$ (91)               | \$ (67)                | \$ 55,758    |
| Provision for loan losses                    | 11,071  |                       |                        | 11,071       |
| Noninterest income (loss)                    | 23,380  | 5,310                 | (270)                  | 28,420       |
| Noninterest expense (income)                 | 46,468  | 4,364                 | (733)                  | 50,099       |
| Income before income taxes                   | 21,757  | 855                   | 396                    | 23,008       |
| Provision for income taxes                   | 5,546   | 338                   | 162                    | 6,046        |
| Net income                                   | \$ 16,211                                       | \$ 517                | \$ 234                 | \$ 16,962    |
| End of period goodwill and other intangibles | \$ 78,877                                       | \$ 12,288             | \$                     | \$ 91,165    |
| End of period assets                         | \$ 2,278,972                                    | \$ 13,190             | \$ 5,263               | \$ 2,297,425 |

**Note 12. Fair Value**

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

The fair value hierarchy is as follows:

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

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

*Securities Available-for-Sale:* Securities classified as available-for-sale are reported at fair value utilizing Level 1 and Level 2 inputs. Securities are classified as Level 1 within the valuation hierarchy when quoted prices are available in an active



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market. This includes securities whose value is based on quoted market prices in active markets for identical assets. The Company also uses Level 1 inputs for the valuation of equity securities traded in active markets.

Securities are classified as Level 2 within the valuation hierarchy when the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U. S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things. Level 2 inputs are used to value U. S. Agency securities, mortgage-backed securities, municipal securities, single issue trust preferred securities, pooled trust preferred securities, and certain equity securities that are not actively traded.

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

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

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

The Company maintains an active and robust problem credit identification system. When a credit is identified as exhibiting characteristics of weakening, the Company will assess the credit for potential impairment. Examples of weakening include delinquency and deterioration of the borrower's capacity to repay as determined by the Company's regular credit review function. As part of the impairment review, the Company will evaluate the current collateral value. It is the Company's standard practice to obtain updated third party collateral valuations to assist management in measuring potential impairment of a credit and the amount of the impairment to be recorded.

Internal collateral valuations are generally performed within two to four weeks of the original identification of potential impairment and receipt of the third party valuation. The internal valuation is performed by comparing the original appraisal to current local real estate market conditions and experience with consideration of liquidation costs. The result of the internal valuation is compared to the outstanding loan balance, and, if warranted, a specific impairment reserve will be established at the completion of the internal evaluation.

A third party evaluation is typically received within thirty to forty-five days of the completion of the internal evaluation. Once received, the third party evaluation is reviewed by Special Assets staff and/or Credit Appraisal staff for reasonableness. Once the evaluation is reviewed and accepted, discounts to fair market value are applied based upon such factors as the bank's historical liquidation experience of like collateral, and an estimated net realizable value is established. That estimated net realizable value is then compared to the outstanding loan balance to determine the amount of specific impairment reserve. The specific impairment reserve, if necessary, is adjusted to reflect the results of the updated evaluation. A specific impairment reserve is generally maintained on impaired loans during the time period while awaiting receipt of the third party evaluation as well as on impaired loans that continue to make some form of payment and liquidation is not imminent. Impaired loans not meeting the aforementioned criteria and that do not have a specific impairment reserve have usually been previously written down through a partial charge-off, to their net realizable value.

Generally, the only difference between current appraised value, adjusted for liquidation costs, and the carrying amount of the loan less the specific reserve is any downward adjustment to the appraised value that the Company determines appropriate. These differences generally consist of costs to sell the property, as well as a deflator for the devaluation of property seen by bank sellers. The Company considers these factors in fair value adjustments.

In the Company's experience, it rarely returns loans to performing status after they have been partially charged off. Generally, credits identified as impaired move quickly through the process towards ultimate resolution.

*Other Real Estate Owned.* The fair value of the Company's other real estate owned is determined using current and prior appraisals, estimates of costs to sell, and proprietary qualitative adjustments. Accordingly, other real estate owned is stated at a Level 3 fair value.

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The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2011, and December 31, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| <i>(In Thousands)</i>                   | September 30, 2011            |            |         | Total<br>Fair Value |
|---|-------------------------------|------------|---------|---------------------|
|   | Fair Value Measurements Using |            |         |                     |
|   | Level 1                       | Level 2    | Level 3 |                     |
| Available-for-sale securities:          |                               |            |         |                     |
| Agency mortgage-backed securities       | \$                            | \$ 254,420 | \$      | \$ 254,420          |
| Non-Agency Alt-A residential MBS        |                               | 10,598     |         | 10,598              |
| State and political subdivisions        |                               | 130,019    |         | 130,019             |
| Corporate FDIC insured                  |                               | 13,775     |         | 13,775              |
| Single issue trust preferred securities |                               | 40,041     |         | 40,041              |
| Equity securities                       | 514                           | 20         |         | 534                 |
| Total available-for-sale securities     | \$ 514                        | \$ 448,873 | \$      | \$ 449,387          |
| Deferred compensation assets            | \$ 2,930                      | \$         | \$      | \$ 2,930            |
| Derivative assets                       |                               |            |         |                     |
| Interest rate lock commitments          |                               | 122        |         | 122                 |
| Total derivative assets                 | \$                            | \$ 122     | \$      | \$ 122              |
| Deferred compensation liabilities       | \$ 2,930                      | \$         | \$      | \$ 2,930            |
| Derivative liabilities                  |                               |            |         |                     |
| Interest rate lock commitments          |                               | 9          |         | 9                   |
| Total derivative liabilities            | \$                            | \$ 9       | \$      | \$ 9                |

| <i>(In Thousands)</i>                   | December 31, 2010             |            |         | Total<br>Fair<br>Value |
|---|-------------------------------|------------|---------|------------------------|
|   | Fair Value Measurements Using |            |         |                        |
|   | Level 1                       | Level 2    | Level 3 |                        |
| Available-for-sale securities:          |                               |            |         |                        |
| U.S. Government agency securities       | \$                            | \$ 9,832   | \$      | \$ 9,832               |
| Agency mortgage-backed securities       |                               | 215,013    |         | 215,013                |
| Non-Agency Alt-A residential MBS        |                               | 11,277     |         | 11,277                 |
| States and political subdivisions       |                               | 176,138    |         | 176,138                |
| Corporate FDIC insured                  |                               | 25,660     |         | 25,660                 |
| Single issue trust preferred securities |                               | 41,244     |         | 41,244                 |
| Pooled trust preferred securities       |                               | 264        |         | 264                    |
| Equity securities                       | 616                           | 20         |         | 636                    |
| Total available-for-sale securities     | \$ 616                        | \$ 479,448 | \$      | \$ 480,064             |
| Deferred compensation assets            | \$ 3,192                      | \$         | \$      | \$ 3,192               |
| Derivative assets                       |                               |            |         |                        |
| Interest rate lock commitments          |                               | 28         |         | 28                     |

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|                                   |    |       |    |    |    |       |
|-----------------------------------|----|-------|----|----|----|-------|
| Total derivative assets           | \$ | \$    | 28 | \$ | \$ | 28    |
| Deferred compensation liabilities | \$ | 3,192 | \$ | \$ | \$ | 3,192 |
| Derivative liabilities            |    |       |    |    |    |       |
| Interest rate swap                |    |       | 31 |    |    | 31    |
| Interest rate lock commitments    |    |       | 59 |    |    | 59    |
| Total derivative liabilities      | \$ | \$    | 90 | \$ | \$ | 90    |

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Certain financial and non-financial assets are measured at fair value on a nonrecurring basis; thus, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances, such as, when there is evidence of impairment. Items subject to nonrecurring fair value adjustments at September 30, 2011, and December 31, 2010, are as follows:

| <i>(In Thousands)</i>   | September 30, 2011            |         |           | Total<br>Fair Value |
|-------------------------|-------------------------------|---------|-----------|---------------------|
|                         | Fair Value Measurements Using |         |           |                     |
|                         | Level 1                       | Level 2 | Level 3   |                     |
| Impaired loans          | \$                            | \$      | \$ 10,291 | \$ 10,291           |
| Restructured loans      |                               |         | 6,524     | 6,524               |
| Other real estate owned |                               |         | 5,942     | 5,942               |

| <i>(In Thousands)</i>   | December 31, 2010             |         |           | Total<br>Fair Value |
|-------------------------|-------------------------------|---------|-----------|---------------------|
|                         | Fair Value Measurements Using |         |           |                     |
|                         | Level 1                       | Level 2 | Level 3   |                     |
| Impaired loans          | \$                            | \$      | \$ 10,906 | \$ 10,906           |
| Restructured loans      |                               |         | 5,771     | 5,771               |
| Other real estate owned |                               |         | 4,910     | 4,910               |

**Fair Value of Financial Instruments**

Fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practical to estimate the value is based upon the characteristics of the instruments and relevant market information. Financial instruments include cash, evidence of ownership in an entity, or contracts that convey or impose on an entity that contractual right or obligation to either receive or deliver cash for another financial instrument. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price if one exists.

| <i>(In Thousands)</i>                          | September 30, 2011 |            | December 31, 2010  |            |
|--|--------------------|------------|--------------------|------------|
|  | Carrying<br>Amount | Fair Value | Carrying<br>Amount | Fair Value |
| <b>Assets</b>                                  |                    |            |                    |            |
| Cash and cash equivalents                      | \$ 148,320         | \$ 148,320 | \$ 112,189         | \$ 112,189 |
| Investment securities                          | 452,729            | 452,771    | 484,701            | 484,768    |
| Loans held for sale                            | 3,575              | 3,625      | 4,694              | 4,700      |
| Loans held for investment, less allowance      | 1,348,249          | 1,373,731  | 1,359,724          | 1,370,173  |
| Accrued interest receivable                    | 6,264              | 6,264      | 7,675              | 7,675      |
| Bank owned life insurance                      | 43,970             | 43,970     | 42,241             | 42,241     |
| Derivative financial assets                    | 122                | 122        | 28                 | 28         |
| Deferred compensation assets                   | 2,930              | 2,930      | 3,192              | 3,192      |
| <b>Liabilities</b>                             |                    |            |                    |            |
| Demand deposits                                | \$ 233,683         | \$ 233,683 | \$ 205,151         | \$ 205,151 |
| Interest-bearing demand deposits               | 295,804            | 295,804    | 262,420            | 262,420    |
| Savings deposits                               | 396,767            | 396,767    | 426,547            | 426,547    |
| Time deposits                                  | 664,237            | 680,996    | 726,837            | 735,332    |
| Securities sold under agreements to repurchase | 139,510            | 160,293    | 140,894            | 161,100    |
| Accrued interest payable                       | 2,754              | 2,754      | 3,264              | 3,264      |
| FHLB and other indebtedness                    | 165,941            | 184,001    | 191,193            | 203,539    |
| Derivative financial liabilities               | 9                  | 9          | 90                 | 90         |
| Deferred compensation liabilities              | 2,930              | 2,930      | 3,192              | 3,192      |

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The following summary presents the methodologies and assumptions used to estimate the fair value of the Company's financial instruments presented below. The information used to determine fair value is highly subjective and judgmental in nature and, therefore, the results may not be precise. Subjective factors include, among other things, estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of the balance sheet date, the amounts that will actually be realized or paid upon settlement or maturity on these various instruments could be significantly different.

*Cash and Cash Equivalents:* The book values of cash and due from banks and federal funds sold and purchased are considered to be equal to fair value as a result of the short-term nature of these items.

*Investment Securities and Deferred Compensation Assets and Liabilities:* Fair values are determined in the same manner as described above.

*Loans:* The estimated fair value of loans held for investment is measured based upon discounted future cash flows using current rates for similar loans. Loans held for sale are recorded at lower of cost or estimated fair value. The fair value of loans held for sale is determined based upon the market sales price of similar loans.

*Accrued Interest Receivable and Payable:* The book value is considered to be equal to the fair value due to the short-term nature of the instrument.

*Bank-owned Life Insurance:* The fair value is determined by stated contract values.

*Derivative Financial Instruments:* The estimated fair value of derivative financial instruments is based upon the current market price for similar instruments.

*Deposits and Securities Sold Under Agreements to Repurchase:* Deposits without a stated maturity, including demand, interest-bearing demand, and savings accounts, are reported at their carrying value. No value has been assigned to the franchise value of these deposits. For other types of deposits and repurchase agreements with fixed maturities and rates, fair value has been estimated by discounting future cash flows based on interest rates currently being offered on instruments with similar characteristics and maturities.

*FHLB and Other Indebtedness:* Fair value has been estimated based on interest rates currently available to the Company for borrowings with similar characteristics and maturities. The fair value for trust preferred obligations has been estimated based on credit spreads seen in the marketplace for like issues.

*Commitments to Extend Credit, Standby Letters of Credit, and Financial Guarantees:* The amount of off-balance sheet commitments to extend credit, standby letters of credit, and financial guarantees is considered equal to fair value. Because of the uncertainty involved in attempting to assess the likelihood and timing of commitments being drawn upon, coupled with the lack of an established market and the wide diversity of fee structures, the Company does not believe it is meaningful to provide an estimate of fair value that differs from the given value of the commitment.

### **Note 13. Derivatives and Hedging Activities**

The Company, through its mortgage banking and risk management operations, is party to various derivative instruments that are used for asset and liability management and customers' financing needs. Derivative assets and liabilities are recorded at fair value on the balance sheet.

The primary derivatives that the Company uses are interest rate swaps and interest rate lock commitments (IRLCs). Generally, these instruments help the Company manage exposure to market risk and meet customer financing needs. Market risk represents the possibility that economic value or net interest income will be adversely affected by fluctuations in external factors, such as interest rates, market-driven loan rates and prices or other economic factors.

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*Interest Rate Swaps.* The Company uses interest rate swap contracts to modify its exposure to interest rate risk. The Company had a derivative interest rate swap instrument that ended in January 2011. The Company employed a cash flow hedging strategy to effectively convert certain floating-rate liabilities into fixed-rate instruments. The interest rate swap was accounted for under the short-cut method as required by the Derivatives and Hedging Topic 815 of the ASC. Changes in fair value of the interest rate swap were reported as a component of other comprehensive income. The Company does not currently employ fair value hedging strategies.

*Interest Rate Lock Commitments.* In the normal course of business, the Company sells originated mortgage loans into the secondary mortgage loan market. During the period of loan origination and prior to the sale of the loans into the secondary market, the Company has exposure to movements in interest rates associated with mortgage loans that are in the mortgage pipeline. A pipeline loan is one on which the potential borrower has set the interest rate for the loan by entering into an IRLC. Once a mortgage loan is closed and funded, it is included within loans held for sale and awaits sale and delivery into the secondary market. During the term of an IRLC, the Company has the risk that interest rates will change from the rate quoted to the borrower.

The Company's balance of mortgage loans held for sale is subject to changes in fair value due to fluctuations in interest rates from the loan closing date through the date of sale of the loan into the secondary market. Typically, the fair value of these loans declines when interest rates increase and rises when interest rates decrease.

The following table presents the aggregate contractual, or notional, amounts of derivative financial instruments as of the dates indicated:

| <i>(In Thousands)</i> | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|-----------------------|--------------------|-------------------|--------------------|
| Interest rate swap    | \$                 | \$ 50,000         | \$ 50,000          |
| IRLC s                | 10,421             | 7,566             | 17,530             |

As of September 30, 2011, December 31, 2010, and September 30, 2010, the fair values of the Company's derivatives were as follows:

| <i>(In Thousands)</i>                | September 30, 2011     |            | December 31, 2010      |            | September 30, 2010     |            |
|--------------------------------------|------------------------|------------|------------------------|------------|------------------------|------------|
|                                      | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives not designated as hedges |                        |            |                        |            |                        |            |
| IRLC s                               | Other assets           | \$ 122     | Other assets           | \$ 28      | Other assets           | \$ 130     |
| Total                                |                        | \$ 122     |                        | \$ 28      |                        | \$ 130     |

| <i>(In Thousands)</i>                | September 30, 2011     |            | December 31, 2010      |            | September 30, 2010     |            |
|--------------------------------------|------------------------|------------|------------------------|------------|------------------------|------------|
|                                      | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedges     |                        |            |                        |            |                        |            |
| Interest rate swap                   | Other liabilities      | \$         | Other liabilities      | \$ 31      | Other liabilities      | \$ 601     |
| Total                                |                        | \$         |                        | \$ 31      |                        | \$ 601     |
| Derivatives not designated as hedges |                        |            |                        |            |                        |            |
| IRLC s                               | Other liabilities      | \$ 9       | Other liabilities      | \$ 59      | Other liabilities      | \$ 50      |
| Total                                |                        | \$ 9       |                        | \$ 59      |                        | \$ 50      |
| Total derivatives                    |                        | \$ 9       |                        | \$ 90      |                        | \$ 651     |



**Table of Contents***Effect of Derivatives and Hedging Activities on the Income Statement*

For the quarters ended September 30, 2011 and 2010, the Company has determined there was no amount of ineffectiveness on cash flow hedges. The following table details gains and losses recognized in income on non-designated hedging instruments for the three- and nine-month periods ended September 30, 2011 and 2010.

| Derivatives Not<br>Designated as Hedging<br>Instruments<br>(In Thousands) | Location of Gain<br>Recognized in Income on<br>Derivative | Amount of Gain<br>Recognized in Income on Derivative |       |                                      |        |
|---|---|--|-------|--------------------------------------|--------|
|   |   | Three Months Ended September 30, 2011                |       | Nine Months Ended September 30, 2010 |        |
|   |   | 2011   | 2010  | 2011                                 | 2010   |
| IRLC s  | Other income  | \$ 81  | \$ 50 | \$ 144                               | \$ 152 |
| Total   |   | \$ 81  | \$ 50 | \$ 144                               | \$ 152 |

*Counterparty Credit Risk.* Like other financial instruments, derivatives contain an element of credit risk. Credit risk is the possibility that the Company will incur a loss because a counterparty, which may be a bank, a broker-dealer or a customer, fails to meet its contractual obligations. This risk is measured as the expected positive replacement value of contracts. All derivative contracts may be executed only with exchanges or counterparties approved by the Company's Asset/Liability Management Committee.

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

Unless the context suggests otherwise, the terms First Community, Company, we, our, and us refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity.

The following discussion and analysis is provided to address information about the Company's financial condition and results of operations for the periods covered. This discussion and analysis should be read in conjunction with the Company's 2010 Annual Report on Form 10-K (2010 Form 10-K) and the other financial information included in this report.

The Company is a multi-state financial holding company headquartered in Bluefield, Virginia, with total assets of \$2.22 billion at September 30, 2011. Through its community bank subsidiary, First Community Bank (the Bank), the Company provides financial, trust and investment advisory services to individuals and commercial customers through 52 locations in Virginia, West Virginia, North Carolina, and Tennessee. The Company is also the parent of Greenpoint Insurance Group, Inc. (Greenpoint), a North Carolina based full-service insurance agency offering commercial and personal lines of insurance. The Bank is the parent of First Community Wealth Management, a 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 Securities and Exchange Commission (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, intend, plan, and similar expressions are intended to identify forward-looking statements. We caution that the forward-looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Actual results, performance or achievements could differ materially from those contemplated, expressed, or implied by the forward-looking statements. The following factors, among others, could cause our 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 we conduct operations;

Geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad;

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 (the Federal Reserve);

Inflation, interest rate, market and monetary fluctuations;

The timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;

The willingness of users to substitute competitors' products and services for our products and services;

The impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;

Technological changes;

The effect of acquisitions we may make, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;

The growth and profitability of noninterest or fee income being less than expected;

Changes in the level of our non-performing assets and charge-offs;

The effect of changes in accounting policies and practices, as may be adopted from time to time by bank regulatory agencies, the SEC, the Public Company Accounting Oversight Board, the Financial Accounting Standards Board or other accounting standards setters;

Possible other-than-temporary impairments of securities held by us;

The impact of current governmental efforts to restructure the U. S. financial regulatory system, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act );

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Changes in consumer spending and savings habits; and

Unanticipated regulatory or judicial proceedings.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Quarterly Report on Form 10-Q and other reports filed by us with the SEC. Therefore, we caution you not to place undue reliance on our forward-looking information and statements.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company. These factors and other risks and uncertainties are discussed in Item 1A., Risk Factors, in Part II of this Quarterly Report on Form 10-Q and the Company's 2010 Form 10-K.

## **APPLICATION OF CRITICAL ACCOUNTING POLICIES**

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

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

The Company's accounting policies are fundamental to understanding Management's Discussion and Analysis of Financial Condition and Results of Operation. The disclosures presented in the Notes to the Consolidated Financial Statements and in Management's Discussion and Analysis provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the accounting for and valuation of investment securities, the determination of the allowance for loan losses, accounting for acquisitions and intangible assets, and accounting for income taxes as the four accounting areas that require the most subjective or complex judgments. The identified critical accounting policies are described in detail in the Company's 2010 Form 10-K.

## **COMPANY OVERVIEW**

The Company is a financial holding company which operates within the four-state region of Virginia, West Virginia, North Carolina, and Tennessee. The Company operates through the Bank, its investment advisory firm, and its insurance agency to offer a wide range of financial services. The Company reported total assets of \$2.22 billion at September 30, 2011.

The Company funds its lending activities primarily through the retail deposit operations of its branch banking network. Retail and wholesale repurchase agreements and borrowings from the Federal Home Loan Bank ( FHLB ) provide additional funding as needed. The Company invests its funds primarily in loans to retail and commercial customers. In addition to loans, the Company invests a portion of its funds in various debt securities, including those of United States agencies, state and political subdivisions, and certain corporate notes and debt instruments. The Company also maintains overnight interest-bearing balances with the Federal Reserve and other correspondent banks. The difference between interest earned on assets and interest paid on liabilities is the Company's primary source of earnings. The Company's net interest income is supplemented by fees for services, commissions on sales, and various deposit service charges.

The Company also conducts asset management activities through the Bank's Trust and Financial Services Division ( Trust Division ) and its registered investment advisory firm, First Community Wealth Management. The Bank's Trust Division



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and Advisory Firm manage assets with an aggregate market value of \$829 million as of September 30, 2011. These assets are not assets of the Company, but are managed under various fee-based arrangements as fiduciary or agent.

## **RECENT LEGISLATION**

On July 21, 2010, sweeping financial regulatory reform legislation entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things, will:

Centralize responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, responsible for implementing, examining and enforcing compliance with federal consumer financial laws.

Require financial holding companies, such as First Community, to be well-capitalized and well-managed as of July 21, 2011. Bank holding companies and banks must also be both well-capitalized and well-managed in order to engage in interstate bank acquisitions.

Impose comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institutions themselves.

Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders.

Make permanent the \$250,000 limit for federal deposit insurance and increase the cash limit of Securities Investor Protection Corporation protection from \$100,000 to \$250,000 and provide unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions.

Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Amend the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

Increase the authority of the Federal Reserve to examine bank holding companies, such as First Community, and their non-bank subsidiaries.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry generally. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

## **RESULTS OF OPERATIONS**

### **Overview**

The following includes significant developments regarding the Company and its operations in the third quarter and first nine months of 2011:

Noninterest income increased \$508 thousand, or 1.79%, for the nine months ended September 30, 2011, as compared to the nine months ended September 30, 2010.

Loan loss provisions were reduced by \$1.16 million, or 37.64%, for the third quarter of 2011, as compared to the second quarter of 2011.

The ratio of non-performing loans to total loans held for investment was 1.73% for the third quarter of 2011, an improvement of 5 basis points from year-end 2010.

**Net Income**

Net income available to common shareholders for the three months ended September 30, 2011, was \$5.03 million, or \$0.28 per diluted common share, compared with net income available to common shareholders of \$6.55 million, or \$0.37 per diluted common share, for the three months ended September 30, 2010, a decrease of \$1.52 million. The decrease in net income was primarily due to the reduction of net gains on the sale of securities between the two periods.

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Net income available to common shareholders for the nine months ended September 30, 2011, was \$16.38 million, or \$0.91 per diluted common share, compared with net income available to common shareholders of \$16.96 million, or \$0.95 per diluted common share, for the nine months ended September 30, 2010, a decrease of \$582 thousand. The decrease in net income was primarily due to the reduction of interest on earning assets, increases in salaries and employee benefits, the payment of preferred stock dividends, and increase in other operating expenses, which were partially offset by a decrease in the provision for loan losses, reduction of interest on deposits and borrowings, and increase in net gains on the sale of securities.

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

Net interest income, the largest contributor to earnings, was \$17.73 million for the three months ended September 30, 2011, compared with \$18.60 million for the corresponding period in 2010, a decrease of \$863 thousand or 4.64%. Tax-equivalent net interest income totaled \$18.41 million for the three months ended September 30, 2011, a decrease of \$1.01 million, or 5.18%, from \$19.42 million for the corresponding period in 2010. The decrease in tax-equivalent net interest income was largely due to decreases in average earning assets and the interest earned on those assets as a result of a sustained low rate environment.

Average earning assets decreased \$54.23 million while average interest-bearing liabilities decreased \$117.58 million during the third quarter of 2011, compared with the same period of 2010. The yield on average earning assets decreased 45 basis points to 4.86% from 5.31% between the three-month periods ended September 30, 2011 and 2010, respectively. Total cost of interest-bearing liabilities decreased 35 basis points between the third quarters of 2011 and 2010, which resulted in a net interest rate spread that was 10 basis points lower, at 3.59%, for the third quarter of 2011, compared with 3.69% for the same period of 2010. The Company's tax-equivalent net interest margin of 3.77% for the three months ended September 30, 2011, decreased 10 basis points from 3.87% for the same period of 2010.

The yield on loans decreased 28 basis points to 5.79% from 6.07% for the three months ended September 30, 2011 and 2010, respectively. Tax-equivalent loan interest income for the third quarter of 2011 decreased \$1.35 million, or 6.29%, compared with the third quarter of 2010. Interest income on loans has been steadily declining due to decreases in the balances of loans and the extended low interest rate environment in the United States.

The tax-equivalent yield on available-for-sale securities decreased 68 basis points to 3.31% during the three months ended September 30, 2011, while the average balance decreased by \$84.06 million, or 16.89%, compared with the same period in 2010. The average balance of the held-to-maturity securities portfolio continued to decline as securities matured or were called and were not replaced.

Average interest-bearing balances with banks were \$140.29 million during the third quarter of 2011, and the yield was 0.21%. Interest-bearing balances with banks are comprised largely of excess liquidity kept at the Federal Reserve and bear overnight market rates.

The average balances of interest-bearing demand deposits increased \$22.16 million, or 8.60%, while the average rate paid during the third quarter of 2011 decreased 31 basis points when compared to the same period in 2010. During the three months ended September 30, 2011, the average balances of savings deposits decreased \$20.14 million, or 4.75%, while the average rate paid decreased 46 basis points compared to the same period in 2010. Average time deposits decreased \$77.86 million, or 10.35%, while the average rate paid on time deposits decreased 45 basis points from 2.07% in the third quarter of 2010 to 1.62% in the third quarter of 2011. The level of average noninterest-bearing demand deposits increased \$16.97 million, or 8.18%, to \$224.54 million during the quarter ended September 30, 2011, compared with the corresponding period of the prior year.

The average balance of retail repurchase agreements, which consist of collateralized retail deposits and commercial treasury accounts, decreased \$15.40 million, or 15.37%, to \$84.81 million for the third quarter of 2011, compared with the same period in 2010. During this same period, the interest rate paid on the retail repurchase agreements decreased 38 basis points to 0.59%. The decrease in the average balance of retail repurchase agreements is largely attributed to customers converting term retail repurchase agreements to more liquid investments and lower balances in commercial treasury accounts in the slow economy. There were no federal funds purchased on average during the third quarters of 2011 and 2010. Wholesale repurchase agreements remained unchanged at \$50.00 million and the rate increased 2 basis points from 3.74% in the third quarter of 2010 to 3.76% in the third quarter of 2011. The average balance of FHLB borrowings and other long-term debt decreased \$26.34 million, or 13.70%, in the third quarter of 2011 to \$165.94 million, compared with the same period in 2010, while the rate paid on those borrowings increased 70 basis points between the periods.

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

Net interest income was \$53.76 million for the nine months ended September 30, 2011, compared with \$55.76 million for the corresponding period in 2010, a decrease of \$2.00 million or 3.58%. Tax-equivalent net interest income totaled \$56.04 million for the nine months ended September 30, 2011, a decrease of \$2.14 million, or 3.68%, from \$58.18 million for the corresponding period in 2010. The decrease in tax-equivalent net interest income was largely due to decreases in average earning assets and decreases in the interest earned on those assets as a result of a sustained low rate environment.

Average earning assets decreased \$31.50 million while interest-bearing liabilities decreased \$84.55 million during the first nine months of 2011, compared with the same period of 2010. The yield on average earning assets decreased 44 basis points to 5.04% from 5.48% between the nine months ended September 30, 2011 and 2010, respectively. Total cost of interest-bearing liabilities decreased 36 basis points between the first nine months of 2011 and 2010, which resulted in a net interest rate spread that was 8 basis points lower, at 3.68%, for the first three quarters of 2011, compared with 3.76% for the same period last year. The Company's tax-equivalent net interest margin of 3.85% for the nine months ended September 30, 2011, decreased 9 basis points from 3.94% for the same period of 2010.

The yield on loans decreased 22 basis points to 5.89% from 6.11% for the nine months ended September 30, 2011 and 2010, respectively. Tax-equivalent loan interest income for the first nine months of 2011 decreased \$3.16 million, or 4.94%, compared with the first three quarters of 2010 due to the effect of the extended low interest rate environment in the United States and reduction in loan volume.

The tax-equivalent yield on available-for-sale securities decreased 68 basis points to 3.81% during the nine months ended September 30, 2011, while the average balance decreased by \$72.06 million, or 14.63%, compared with the same period in 2010. The average balance of the held-to-maturity securities portfolio continued to decline as securities matured or were called and were not replaced.

Average interest-bearing balances with banks were \$141.20 million during the first nine months of 2011, and the yield was 0.23%. Interest-bearing balances with banks are comprised largely of excess liquidity kept at the Federal Reserve and bear overnight market rates.

The average balances of interest-bearing demand deposits increased \$29.51 million, or 11.92%, while the average rate paid during the first nine months of 2011 decreased 20 basis points when compared to the same period in 2010. During the nine months ended September 30, 2011, the average balances of savings deposits decreased \$4.35 million, or 1.04%, while the average rate paid decreased 48 basis points compared to the same period in 2010. Average time deposits decreased \$73.73 million, or 9.59%, while the average rate paid on time deposits decreased 44 basis points from 2.17% for the first nine months of 2010 to 1.73% for the first nine months of 2011. The level of average noninterest-bearing demand deposits increased \$13.95 million, or 6.82%, to \$218.66 million for the nine months ended September 30, 2011, compared with the corresponding period of the prior year.

The average balance of retail repurchase agreements, which consist of collateralized retail deposits and commercial treasury accounts, decreased \$10.43 million, or 10.92%, to \$85.06 million for the first nine months of 2011, compared with the same period in 2010. During this same period, the interest rate paid on the retail repurchase agreements decreased 39 basis points to 0.69%. The decrease in the average balance of retail repurchase agreements is largely attributed to customers converting term retail repurchase agreements to more liquid investments and lower balances in commercial treasury accounts in the slow economy. There were no federal funds purchased on average during the first three quarters of 2011 and 2010. Wholesale repurchase agreements remained unchanged at \$50.00 million for the nine months ended September 30, 2011 and 2010, while the rate increased 2 basis points between the periods due to changes in the structure within those borrowings. The average balance of FHLB borrowings and other long-term debt decreased \$25.55 million, or 13.06%, in the first nine months of 2011 to \$170.03 million compared to the same period in 2010, while the rate paid on those borrowings increased 55 basis points between the periods. The Company prepaid a \$25.00 million FHLB convertible advance that carried a 4.00% interest rate during the first quarter of 2011. That convertible advance was a structured borrowing where the interest rate floated with 3-month LIBOR, but changed to a 4.00% fixed cost in the first quarter of 2011.

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

|   | Three Months Ended September 30, |               |                  |                     |               |                  |
|---|----------------------------------|---------------|------------------|---------------------|---------------|------------------|
|   | 2011                             |               |                  | 2010                |               |                  |
| (Dollars in Thousands)                            | Average Balance                  | Interest (1)  | Average Rate (1) | Average Balance     | Interest (1)  | Average Rate (1) |
| <b>Assets</b>                                     |                                  |               |                  |                     |               |                  |
| <b>Earning assets</b>                             |                                  |               |                  |                     |               |                  |
| Loans (2)   | \$ 1,379,144                     | \$ 20,126     | 5.79%            | \$ 1,404,746        | \$ 21,478     | 6.07%            |
| Securities available-for-sale                     | 413,538                          | 3,447         | 3.31%            | 497,602             | 4,999         | 3.99%            |
| Securities held-to-maturity                       | 3,753                            | 78            | 8.25%            | 6,084               | 128           | 8.35%            |
| Interest-bearing deposits                         | 140,285                          | 75            | 0.21%            | 82,521              | 54            | 0.26%            |
| <b>Total earning assets</b>                       | <b>1,936,720</b>                 | <b>23,726</b> | <b>4.86%</b>     | <b>1,990,953</b>    | <b>26,659</b> | <b>5.31%</b>     |
| Other assets                                      | 254,425                          |               |                  | 280,031             |               |                  |
| <b>Total assets</b>                               | <b>\$ 2,191,145</b>              |               |                  | <b>\$ 2,270,984</b> |               |                  |
| <b>Liabilities</b>                                |                                  |               |                  |                     |               |                  |
| <b>Interest-bearing deposits</b>                  |                                  |               |                  |                     |               |                  |
| Demand deposits                                   | \$ 279,722                       | \$ 80         | 0.11%            | \$ 257,560          | \$ 274        | 0.42%            |
| Savings deposits                                  | 403,688                          | 171           | 0.17%            | 423,827             | 672           | 0.63%            |
| Time deposits                                     | 674,528                          | 2,747         | 1.62%            | 752,383             | 3,926         | 2.07%            |
| <b>Total interest-bearing deposits</b>            | <b>1,357,938</b>                 | <b>2,998</b>  | <b>0.88%</b>     | <b>1,433,770</b>    | <b>4,872</b>  | <b>1.35%</b>     |
| <b>Borrowings</b>                                 |                                  |               |                  |                     |               |                  |
| Retail repurchase agreements                      | 84,813                           | 126           | 0.59%            | 100,217             | 245           | 0.97%            |
| Wholesale repurchase agreements                   | 50,000                           | 474           | 3.76%            | 50,000              | 471           | 3.74%            |
| FHLB borrowings and other indebtedness            | 165,938                          | 1,718         | 4.11%            | 192,280             | 1,655         | 3.41%            |
| <b>Total borrowings</b>                           | <b>300,751</b>                   | <b>2,318</b>  | <b>3.06%</b>     | <b>342,497</b>      | <b>2,371</b>  | <b>2.75%</b>     |
| <b>Total interest-bearing liabilities</b>         | <b>1,658,689</b>                 | <b>5,316</b>  | <b>1.27%</b>     | <b>1,776,267</b>    | <b>7,243</b>  | <b>1.62%</b>     |
| Noninterest-bearing demand deposits               | 224,543                          |               |                  | 207,569             |               |                  |
| Other liabilities                                 | 1,389                            |               |                  | 13,147              |               |                  |
| Stockholders' equity                              | 306,524                          |               |                  | 274,001             |               |                  |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 2,191,145</b>              |               |                  | <b>\$ 2,270,984</b> |               |                  |
| Net interest income, tax-equivalent               |                                  | \$ 18,410     |                  |                     | \$ 19,416     |                  |
| Net interest rate spread (3)                      |                                  |               | 3.59%            |                     |               | 3.69%            |
| Net interest margin (4)                           |                                  |               | 3.77%            |                     |               | 3.87%            |

(1) Fully taxable equivalent at the rate of 35% ( FTE ). 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 earning assets.



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

|   | Nine Months Ended September 30, |               |                  |                     |               |                  |
|---|---------------------------------|---------------|------------------|---------------------|---------------|------------------|
|   | 2011                            |               |                  | 2010                |               |                  |
| (Dollars in Thousands)                            | Average Balance                 | Interest (1)  | Average Rate (1) | Average Balance     | Interest (1)  | Average Rate (1) |
| <b>Assets</b>                                     |                                 |               |                  |                     |               |                  |
| <b>Earning assets</b>                             |                                 |               |                  |                     |               |                  |
| Loans (2)   | \$ 1,378,540                    | \$ 60,755     | 5.89%            | \$ 1,399,347        | \$ 63,913     | 6.11%            |
| Securities available-for-sale                     | 420,544                         | 11,991        | 3.81%            | 492,603             | 16,561        | 4.49%            |
| Securities held-to-maturity                       | 4,203                           | 263           | 8.37%            | 6,713               | 421           | 8.38%            |
| Interest-bearing deposits                         | 141,198                         | 244           | 0.23%            | 77,319              | 134           | 0.23%            |
| <b>Total earning assets</b>                       | <b>1,944,485</b>                | <b>73,253</b> | <b>5.04%</b>     | <b>1,975,982</b>    | <b>81,029</b> | <b>5.48%</b>     |
| Other assets                                      | 260,413                         |               |                  | 282,628             |               |                  |
| <b>Total assets</b>                               | <b>\$ 2,204,898</b>             |               |                  | <b>\$ 2,258,610</b> |               |                  |
| <b>Liabilities</b>                                |                                 |               |                  |                     |               |                  |
| <b>Interest-bearing deposits</b>                  |                                 |               |                  |                     |               |                  |
| Demand deposits                                   | \$ 277,109                      | \$ 404        | 0.19%            | \$ 247,596          | \$ 724        | 0.39%            |
| Savings deposits                                  | 415,197                         | 769           | 0.25%            | 419,550             | 2,284         | 0.73%            |
| Time deposits                                     | 695,150                         | 8,978         | 1.73%            | 768,882             | 12,472        | 2.17%            |
| <b>Total interest-bearing deposits</b>            | <b>1,387,456</b>                | <b>10,151</b> | <b>0.98%</b>     | <b>1,436,028</b>    | <b>15,480</b> | <b>1.44%</b>     |
| <b>Borrowings</b>                                 |                                 |               |                  |                     |               |                  |
| Retail repurchase agreements                      | 85,064                          | 440           | 0.69%            | 95,494              | 773           | 1.08%            |
| Wholesale repurchase agreements                   | 50,000                          | 1,409         | 3.77%            | 50,000              | 1,402         | 3.75%            |
| FHLB borrowings and other indebtedness            | 170,034                         | 5,212         | 4.10%            | 195,586             | 5,194         | 3.55%            |
| <b>Total borrowings</b>                           | <b>305,098</b>                  | <b>7,061</b>  | <b>3.09%</b>     | <b>341,080</b>      | <b>7,369</b>  | <b>2.89%</b>     |
| <b>Total interest-bearing liabilities</b>         | <b>1,692,554</b>                | <b>17,212</b> | <b>1.36%</b>     | <b>1,777,108</b>    | <b>22,849</b> | <b>1.72%</b>     |
| Noninterest-bearing demand deposits               | 218,659                         |               |                  | 204,706             |               |                  |
| Other liabilities                                 | 2,454                           |               |                  | 9,799               |               |                  |
| Stockholders' equity                              | 291,231                         |               |                  | 266,997             |               |                  |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 2,204,898</b>             |               |                  | <b>\$ 2,258,610</b> |               |                  |
| Net interest income, tax-equivalent               |                                 | \$ 56,041     |                  |                     | \$ 58,180     |                  |
| Net interest rate spread (3)                      |                                 |               | 3.68%            |                     |               | 3.76%            |
| Net interest margin (4)                           |                                 |               | 3.85%            |                     |               | 3.94%            |

(1) Fully taxable equivalent at the rate of 35% ( FTE ). 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 earning assets.

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The following table summarizes the changes in tax-equivalent interest earned and paid detailing the amounts attributable to (i) changes in volume (change in the average volume times the prior year's average rate), (ii) changes in rate (changes in the average rate times the prior year's average volume), and (iii) changes in rate/volume (change in the average volume column times the change in average rate).

| <i>(In Thousands)</i>                                | <b>Three Months Ended<br/>September 30, 2011, Compared to 2010<br/>Dollar Increase (Decrease) due to</b> |                 |                         |                   | <b>Nine Months Ended<br/>September 30, 2011, Compared to 2010<br/>Dollar Increase (Decrease) due to</b> |                 |                         |                   |
|--|--|-----------------|-------------------------|-------------------|---|-----------------|-------------------------|-------------------|
|  | <b>Volume</b>  | <b>Rate</b>     | <b>Rate/<br/>Volume</b> | <b>Total</b>      | <b>Volume</b>   | <b>Rate</b>     | <b>Rate/<br/>Volume</b> | <b>Total</b>      |
| <b>Interest earned on:</b>                           |  |                 |                         |                   |   |                 |                         |                   |
| Loans (FTE)  | \$ (391)   | \$ (978)        | \$ 17                   | \$ (1,352)        | \$ (950)  | \$ (2,241)      | \$ 33                   | \$ (3,158)        |
| Securities available-for-sale (FTE)                  | (845)  | (851)           | 144                     | (1,552)           | (2,423)   | (2,515)         | 368                     | (4,570)           |
| Securities held-to-maturity (FTE)                    | (49)   | (2)             | 1                       | (50)              | (157)   | (1)             | 0                       | (158)             |
| Interest-bearing deposits with other banks           | 38   | (10)            | (7)                     | 21                | 110   | (0)             | 0                       | 110               |
| <b>Total interest earning assets</b>                 | <b>(1,247)</b>   | <b>(1,841)</b>  | <b>155</b>              | <b>(2,933)</b>    | <b>(3,420)</b>  | <b>(4,757)</b>  | <b>401</b>              | <b>(7,776)</b>    |
| <b>Interest paid on:</b>                             |  |                 |                         |                   |   |                 |                         |                   |
| Demand deposits                                      | 24   | (201)           | (17)                    | (194)             | 86  | (363)           | (43)                    | (320)             |
| Savings deposits                                     | (32)   | (492)           | 23                      | (501)             | (24)  | (1,507)         | 16                      | (1,515)           |
| Time deposits  | (406)  | (862)           | 89                      | (1,179)           | (1,196)   | (2,542)         | 244                     | (3,494)           |
| Retail repurchase agreements                         | (38)   | (96)            | 15                      | (119)             | (84)  | (279)           | 30                      | (333)             |
| Wholesale repurchase agreements                      |  | 3               | (0)                     | 3                 |   | 7               | 0                       | 7                 |
| FHLB borrowings and other long-term debt             | (227)  | 336             | (46)                    | 63                | (679)   | 801             | (104)                   | 18                |
| <b>Total interest-bearing liabilities</b>            | <b>(679)</b>   | <b>(1,312)</b>  | <b>64</b>               | <b>(1,927)</b>    | <b>(1,897)</b>  | <b>(3,883)</b>  | <b>143</b>              | <b>(5,637)</b>    |
| <b>Change in net interest income, tax-equivalent</b> | <b>\$ (568)</b>  | <b>\$ (529)</b> | <b>\$ 91</b>            | <b>\$ (1,006)</b> | <b>\$ (1,523)</b>   | <b>\$ (875)</b> | <b>\$ 259</b>           | <b>\$ (2,139)</b> |

**Provision and Allowance for Loan Losses**

During the last four years, there has been significant stress in both commercial and residential real estate markets, resulting in significant declines in real estate valuations. Decreases in real estate values adversely affect the value of property used as collateral for loans, including loans originated by the Company. In addition, adverse changes in the economy, particularly continued high rates of unemployment, may have a negative effect on the ability of the Company's borrowers to make timely loan payments. A further increase in loan delinquencies could adversely impact loan loss experience, causing potential increases in the provision and allowance for loan losses.

The Company's allowance for loan losses was \$26.41 million at September 30, 2011, \$26.48 million at December 31, 2010, and \$26.42 million at September 30, 2010. The Company's allowance for loan loss activity for the three- and nine-month periods ended September 30, 2011 and 2010 is as follows:

| <i>(In Thousands)</i>            | <b>For the Three Months<br/>Ended September 30,<br/>2011</b> |                | <b>For the Nine Months<br/>Ended September 30,<br/>2010</b> |                |
|----------------------------------|--|----------------|---|----------------|
|                                  | <b>2011</b>  | <b>2010</b>    | <b>2011</b>   | <b>2010</b>    |
| <b>Allowance for loan losses</b> |  |                |   |                |
| Beginning balance                | \$ 26,482  | \$ 25,011      | \$ 26,482   | \$ 24,277      |
| Provision for loan losses        | 1,920  | 3,810          | 6,611   | 11,071         |
| Charge-offs                      | (3,062)  | (2,651)        | (8,545)   | (9,756)        |
| Recoveries                       | 1,067  | 250            | 1,859   | 828            |
| <b>Net charge-offs</b>           | <b>(1,995)</b>   | <b>(2,401)</b> | <b>(6,686)</b>  | <b>(8,928)</b> |

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|                |           |           |           |           |
|----------------|-----------|-----------|-----------|-----------|
| Ending balance | \$ 26,407 | \$ 26,420 | \$ 26,407 | \$ 26,420 |
|----------------|-----------|-----------|-----------|-----------|

The total allowance for loan losses to loans held for investment ratio was 1.92% at September 30, 2011, compared with 1.91% at December 31, 2010, and 1.89% at September 30, 2010. Management considers the allowance to be adequate based upon its analysis of the portfolio as of September 30, 2011. Although management utilizes its best judgment and information

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available, the adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities towards loan classifications. In addition, the determination of the allowance for loan losses necessarily requires management to make various assumptions. Therefore, actual loan losses could differ materially from management's determination if actual conditions differ significantly from the assumptions utilized. The allowance methodology was recently enhanced to further segment the loan portfolio and refine qualitative adjustments to the consumer loan segments. Historical loss rates for each risk grade are adjusted by environmental factors to estimate the amount of reserve needed by segment. The Company believes these enhancements result in increased granularity within the allowance for loan losses and is more reflective of trends within the loan portfolio.

During the third quarter and first nine months of 2011, the Company incurred net charge-offs of \$2.00 million and \$6.69 million, respectively, compared with \$2.40 million and \$8.93 million in the respective periods of 2010. Annualized net charge-offs for the third quarter of 2011 were 0.57% of the average loan balance, compared to 0.68% of the average loan balance for the same period in 2010. The Company made provisions for loan losses of \$1.92 million and \$6.61 million, respectively, for the three- and nine-month periods ended September 30, 2011, compared to \$3.81 million and \$11.07 million, respectively, in the same period of 2010. Provisions for loan losses covered 96.24% and 98.88%, respectively, of net charge-offs for the three- and nine-month periods ended September 30, 2011.

Total delinquent loans as of September 30, 2011, measured 2.30% of total loans, of which 0.64% were comprised of loans 30-89 days delinquent and 1.66% were comprised of loans in non-accrual status. Total delinquent loans have decreased approximately \$4.75 million, or 13.04%, since December 31, 2010. Non-performing loans, comprised of non-accrual loans and unseasoned loan restructurings (as the Company does not have any loans that are 90 days past due and still accruing), as a percentage of total loans were 1.73% at September 30, 2011, 1.78% at December 31, 2010, and 1.76% at September 30, 2010.

At September 30, 2011, non-accrual loans, including acquired, impaired non-accrual loans, were primarily composed of the following categories of loans: 34.69% were non-farm, non-residential commercial loans; 33.10% were single family residential mortgage; and 18.79% were commercial and industrial loans. Approximately \$3.10 million, or 13.55%, of non-accrual loans at September 30, 2011, were attributed to the TriStone loan portfolio that was acquired during the third quarter of 2009.

The decrease in special mention loans is primarily attributed to four significant loans migrating to pass based on positive payment performance.

**Noninterest Income**

Noninterest income consists of all revenues that are not included in interest and fee income related to earning assets. Total noninterest income for the third quarter of 2011 was \$8.07 million, compared with noninterest income of \$10.94 million in the same period of 2010, a decrease of \$2.87 million. Exclusive of the impact of other-than-temporary impairment ( OTTI ) charges and gains on the sale of securities, noninterest income for the quarter ended September 30, 2011, decreased \$266 thousand, or 3.18%, compared to the same period in 2010. Wealth management revenues decreased \$41 thousand, or 4.51%, to \$868 thousand for the three months ended September 30, 2011, compared with the same period in 2010. Service charges on deposit accounts decreased \$53 thousand, or 1.53%, to \$3.40 million for the three months ended September 30, 2011, compared with the same period in 2010. Other service charges and fees increased \$182 thousand, or 14.63%, to \$1.43 million for the three months ended September 30, 2011, compared with the same period in 2010. Insurance commissions for the third quarter of 2011 were \$1.52 million, a decrease of \$140 thousand, or 8.42%, from the comparable period in 2010. The agency offices sold during the third quarter of 2011 generated approximately \$1.00 million in annual premium commission revenue. Other operating income totaled \$877 thousand for the three months ended September 30, 2011, a decrease of \$214 thousand, or 19.62%, compared with the same period in 2010. For the quarter ended September 30, 2011, the Company recognized \$210 thousand of OTTI charges related to a non-agency mortgage-backed security, compared to no OTTI charges during the same period of 2010. During the third quarter of 2011, net securities gains of \$178 thousand were realized, compared with net gains of \$2.57 million in the comparable period in 2010.

Noninterest income for the first nine months of 2011 was \$28.93 million, compared with noninterest income of \$28.42 million in the same period of 2010, an increase of \$508 thousand. Exclusive of the impact of OTTI charges and gains on the sale of securities, noninterest income for the nine months ended September 30, 2011, decreased \$153 thousand, or 0.62%, compared to the same period in 2010. Wealth management revenues decreased \$114 thousand, or 4.06%, to \$2.69 million for the first nine months of 2011, compared with the same period in 2010. Service charges on deposit accounts decreased \$8

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thousand, or 0.08%, to \$9.79 million for the nine months ended September 30, 2011, compared with the same period in 2010. Other service charges and fees increased \$518 thousand, or 13.72%, to \$4.29 million for the nine months ended September 30, 2011, compared with the same period in 2010. Insurance commissions for the first nine months of 2011 were \$5.03 million, a decrease of \$226 thousand, or 4.30%, from the comparable period in 2010. The decrease in insurance commissions reflects the effects of the recent recession, as well as the soft insurance market. Other operating income totaled \$2.63 million for the nine months ended September 30, 2011, a decrease of \$323 thousand, or 10.95%, compared with the same period in 2010. For the nine months ended September 30, 2011, the Company recognized \$737 thousand of OTTI charges related to a non-agency mortgage-backed security, compared to \$185 thousand of OTTI charges related to two pooled trust preferred securities and several small equity holdings during the same period of 2010. During the first nine months of 2011, net securities gains of \$5.24 million were realized compared with net gains of \$4.03 million in the comparable period in 2010. Additionally, approximately \$967 thousand of the gains realized during the period were recoveries of investment security impairments that occurred during 2009.

For a more detailed discussion of investment securities and impairment charges, please see Note 3 to the Consolidated Financial Statements included in Part I.

**Noninterest Expense**

Noninterest expense totaled \$16.06 million for the quarter ended September 30, 2011, a decrease of \$1.37 million, or 7.85%, from the same period in 2010. Salaries and employee benefits for the third quarter of 2011 decreased \$344 thousand, or 3.93%, compared to the same period in 2010. Occupancy and furniture and equipment expenses decreased \$161 thousand, or 6.44%, between the comparable periods. Deposit insurance premiums and assessments were \$348 thousand for the three-month period ended September 30, 2011, a decrease of \$370 thousand, or 51.53%, compared to the same period in 2010, which was primarily due to the FDIC's change in assessment methodology for deposit insurance to one based on tangible assets. Other operating expense totaled \$4.72 million for the third quarter of 2011, a decrease of \$484 thousand, or 9.31%, from \$5.20 million for the third quarter of 2010. The decrease in other operating expense was primarily due to a decrease of \$127 thousand in expenses and losses associated with other real estate owned between the comparable periods.

Noninterest expense totaled \$51.86 million for the nine months ended September 30, 2011, an increase of \$1.76 million, or 3.52%, from the same period in 2010. Salaries and employee benefits for the first nine months of 2011 increased \$1.01 million, or 4.02%, compared to the same period in 2010. The Company has increased staffing levels in credit administration, marketing, and compliance due to increasing regulatory burdens. The Company has also experienced a significant increase in health insurance costs in recent quarters. Occupancy and furniture and equipment expenses decreased \$223 thousand, or 2.93%, between the comparable periods. Deposit insurance premiums and assessments were \$1.64 million for the nine-month period ended September 30, 2011, a decrease of \$489 thousand, or 22.97%, compared to the same period in 2010. Other operating expense totaled \$15.38 million for the first nine months of 2011, an increase of \$988 thousand, or 6.86%, from \$14.39 million for the first nine months of 2010. The increase in other operating expense was primarily due to an increase of \$786 thousand in expenses and losses associated with other real estate owned.

During the first quarter of 2011, the Company prepaid a \$25.00 million FHLB advance, and the expense associated with that prepayment was \$471 thousand.

**Income Tax Expense**

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are commonly referred to as permanent differences. The most significant permanent differences for the Company include income on municipal securities which are exempt from federal income tax and the increases in the cash surrender values of life insurance policies.

For the third quarter of 2011, income taxes were \$2.50 million, compared with income taxes of \$1.74 million for the third quarter of 2010. For the quarters ended September 30, 2011 and 2010, the effective tax expense rates were 31.99% and 21.01%, respectively. For the nine months ended September 30, 2011, income taxes were \$7.42 million, compared with \$6.05 million for the same period of 2010. For the nine months ended September 30, 2011 and 2010, the effective tax expense rates were 30.65% and 26.28%, respectively.

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### **FINANCIAL CONDITION**

Total assets at September 30, 2011, decreased \$24.15 million, or 1.09%, to \$2.22 billion from December 31, 2010. As of September 30, 2011, cash and cash equivalents increased \$36.13 million since year-end 2010. At September 30, 2011, total liabilities were \$1.92 billion, a decrease of \$58.39 million, or 2.96%, from December 31, 2010. Deposits decreased \$30.46 million, securities sold under agreements to repurchase decreased \$1.38 million, and borrowings decreased \$25.25 million during the nine-month period ended September 30, 2011.

#### **Securities**

Available-for-sale securities were \$449.39 million at September 30, 2011, compared with \$480.06 million at December 31, 2010, a decrease of \$30.68 million or 6.83%. The market value of securities available-for-sale as a percentage of amortized cost improved from 96.40% at December 31, 2010, to 97.56% at September 30, 2011, reflecting improved pricing on certain issues. Held-to-maturity securities declined to \$3.34 million at September 30, 2011, compared with \$4.64 million at December 31, 2010.

During the three- and nine-month periods ended September 30, 2011, the Company recognized OTTI charges in earnings on a non-agency mortgage-backed security of \$210 thousand and \$737 thousand, respectively. During the three- and nine-month periods ended September 30, 2011, the Company recognized no OTTI charges on equity securities. During the three-month period ended September 30, 2010, the Company incurred no OTTI charges. During the nine-month period ended September 30, 2010, the Company incurred credit-related OTTI charges on beneficial interest debt securities of \$134 thousand and OTTI charges on certain of its equity securities of \$51 thousand.

For a more detailed discussion of investment securities, please see Note 3 to the Consolidated Financial Statements included in Part I.

#### **Loan Portfolio**

##### ***Loans Held for Sale***

The \$3.58 million balance of loans held for sale at September 30, 2011, represents mortgage loans that are sold to investors on a best efforts basis. Accordingly, the Company does not retain the interest rate risk involved in the commitment. The gross notional amount of outstanding commitments to originate mortgage loans for customers at September 30, 2011, was \$10.42 million on 64 loans.

##### ***Loans Held for Investment***

Total loans held for investment were \$1.37 billion at September 30, 2011, representing a decrease of \$11.55 million from December 31, 2010, and a decrease of \$23.60 million from September 30, 2010. The average loan to deposit ratio was 87.15% for the third quarter of 2011, compared with 85.54% for the fourth quarter of 2010, and 85.59% for the third quarter of 2010. Year-to-date average loans of \$1.38 billion decreased \$20.81 million when compared to year-to-date average loans of \$1.40 billion in 2010.

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The held for investment loan portfolio continues to be diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition as of September 30, 2011, December 31, 2010, and September 30, 2010.

| <i>(Dollars in Thousands)</i>           | September 30, 2011  |                | December 31, 2010   |                | September 30, 2010  |                |
|---|---------------------|----------------|---------------------|----------------|---------------------|----------------|
|   | Amount              | Percent        | Amount              | Percent        | Amount              | Percent        |
| <b>Loans Held for Investment</b>        |                     |                |                     |                |                     |                |
| <b>Commercial loans</b>                 |                     |                |                     |                |                     |                |
| Construction commercial                 | \$ 32,279           | 2.35%          | \$ 42,694           | 3.08%          | \$ 52,674           | 3.77%          |
| Land development                        | 3,304               | 0.24%          | 16,650              | 1.20%          | 20,511              | 1.47%          |
| Other land loans                        | 23,001              | 1.67%          | 24,468              | 1.77%          | 20,578              | 1.47%          |
| Commercial and industrial               | 92,894              | 6.76%          | 94,123              | 6.79%          | 103,021             | 7.37%          |
| Single family residential               | 107,879             | 7.85%          | N/A                 | N/A            | N/A                 | N/A            |
| Multi-family residential                | 82,939              | 6.03%          | 67,824              | 4.89%          | 67,638              | 4.84%          |
| Non-farm, non-residential               | 325,830             | 23.70%         | 351,904             | 25.39%         | 354,552             | 25.35%         |
| Agricultural                            | 1,570               | 0.12%          | 1,342               | 0.10%          | 1,391               | 0.10%          |
| Farmland                                | 36,605              | 2.66%          | 36,954              | 2.67%          | 37,997              | 2.72%          |
| <b>Total commercial loans</b>           | <b>706,301</b>      | <b>51.38%</b>  | <b>635,959</b>      | <b>45.89%</b>  | <b>658,362</b>      | <b>47.09%</b>  |
| <b>Consumer real estate loans</b>       |                     |                |                     |                |                     |                |
| Home equity lines                       | 109,444             | 7.96%          | 111,620             | 8.05%          | 113,909             | 8.14%          |
| Single family residential mortgage      | 461,104             | 33.54%         | 549,157             | 39.61%         | 533,976             | 38.19%         |
| Owner-occupied construction             | 19,279              | 1.40%          | 18,349              | 1.32%          | 21,266              | 1.52%          |
| <b>Total consumer real estate loans</b> | <b>589,827</b>      | <b>42.90%</b>  | <b>679,126</b>      | <b>48.98%</b>  | <b>669,151</b>      | <b>47.85%</b>  |
| <b>Consumer and other loans</b>         |                     |                |                     |                |                     |                |
| Consumer loans                          | 67,020              | 4.88%          | 63,475              | 4.58%          | 63,186              | 4.52%          |
| Other                                   | 11,508              | 0.84%          | 7,646               | 0.55%          | 7,552               | 0.54%          |
| <b>Total consumer and other loans</b>   | <b>78,528</b>       | <b>5.72%</b>   | <b>71,121</b>       | <b>5.13%</b>   | <b>70,738</b>       | <b>5.06%</b>   |
| <b>Total</b>                            | <b>\$ 1,374,656</b> | <b>100.00%</b> | <b>\$ 1,386,206</b> | <b>100.00%</b> | <b>\$ 1,398,251</b> | <b>100.00%</b> |
| <b>Loans Held for Sale</b>              | <b>\$ 3,575</b>     |                | <b>\$ 4,694</b>     |                | <b>\$ 3,386</b>     |                |

**Non-Performing Assets**

Non-performing assets include loans on non-accrual status, unseasoned loan restructurings, loans contractually past due 90 days or more and still accruing interest, and other real estate owned ( OREO ). Non-performing assets were \$29.78 million at September 30, 2011, \$29.65 million at December 31, 2010, and \$30.05 million at September 30, 2010. The percentage of non-performing assets to total assets was 1.34% at September 30, 2011, 1.32% at December 31, 2010, and 1.31% at September 30, 2010.

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The following table details non-performing assets by category at the close of each of the quarters ended September 30, 2011, December 31, 2010, and September 30, 2010.

| <i>(Dollars in Thousands)</i>  | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|--|--------------------|-------------------|--------------------|
| Non-accrual loans  | \$ 22,877          | \$ 19,414         | \$ 16,645          |
| Restructured loans   | 964                | 5,325             | 7,904              |
| Loans 90 days or more past due and still accruing interest                       |                    |                   |                    |
| <b>Total non-performing loans</b>  | <b>23,841</b>      | <b>24,739</b>     | <b>24,549</b>      |
| <b>Other real estate owned</b>   | <b>5,942</b>       | <b>4,910</b>      | <b>5,501</b>       |
| <b>Total non-performing assets</b>   | <b>\$ 29,783</b>   | <b>\$ 29,649</b>  | <b>\$ 30,050</b>   |
| <b>Restructured loans performing in accordance with modified terms</b>           | <b>\$ 1,156</b>    | <b>\$ 3,911</b>   | <b>\$ 849</b>      |
| Non-performing loans as a percentage of total loans                              | 1.73%              | 1.78%             | 1.76%              |
| Non-performing assets as a percentage of total assets                            | 1.34%              | 1.32%             | 1.31%              |
| Non-performing assets as a percentage of total loans and other real estate owned | 2.16%              | 2.13%             | 2.14%              |
| Allowance for loan losses as a percentage of non-performing loans                | 110.76%            | 107.05%           | 107.62%            |

Ongoing activity within the classification and categories of non-performing loans include collections on delinquencies, foreclosures, loan restructurings, and movements into or out of the non-performing classification as a result of changing economic conditions, borrower financial capacity, and resolution efforts on the part of the Company. There were no loans 90 days past due and still accruing at September 30, 2011, December 31, 2010, or September 30, 2010. OREO was \$5.94 million at September 30, 2011, an increase of \$1.03 million from December 31, 2010, and is carried at the lesser of estimated net realizable value or cost. OREO increased from December 31, 2010, as a result of escalation in asset resolution and foreclosure activity. At September 30, 2011, OREO consisted of 56 properties with an average book value of \$171 thousand and an average holding period of 5 months. During the three- and nine-month periods ended September 30, 2011, net losses on the sale of OREO totaled \$431 thousand and \$2.13 million, respectively.

The Company's Special Assets staff assumes the management and monitoring of all loans determined to be seriously delinquent or impaired. When resolution of delinquent loans through secondary repayment sources becomes evident, updated appraisals are ordered and the Company generally begins to complete the tasks necessary to gain control of the collateral and prepare for liquidation including, but not limited to, engagement of counsel, inspection of collateral, and continued communication with the borrower, if appropriate. Special Assets staff also regularly reviews the relationship to identify any potential adverse developments during this time and continues to seek alternative resolution processes, where possible.

At September 30, 2011, the allowance for loan losses related to total loan restructurings was \$959 thousand. Total interest income recognized on loan restructurings for the three- and nine- month periods ended September 30, 2011, totaled \$173 thousand and \$428 thousand, respectively. When restructuring loans for troubled borrowers, the Company generally makes concessions in interest rates and amortization terms. After twelve months of satisfactory payment performance restructured loans are generally not reported as restructured loans, but remain identified as impaired loans until full payment or other satisfaction of the obligation.

**Table of Contents****Deposits and Other Borrowings**

Total deposits decreased \$30.46 million, or 1.88%, during the first nine months of 2011. Noninterest-bearing demand deposits increased \$28.53 million to \$233.68 million at September 30, 2011, compared with \$205.15 million at December 31, 2010. Interest-bearing demand deposits increased \$33.38 million to \$295.80 million at September 30, 2011, from December 31, 2010. Savings decreased \$29.78 million, or 6.98%, and time deposits decreased \$62.60 million, or 8.61%, during the first nine months of 2011.

Securities sold under repurchase agreements decreased \$1.38 million, or 0.99%, during the first nine months of 2011 to \$139.51 million. There were no federal funds purchased outstanding at September 30, 2011, as the Company maintained a strong liquidity position throughout the first nine months of 2011.

**Stockholders Equity**

Total stockholders equity increased \$34.24 million, or 12.69%, from \$269.88 million at December 31, 2010, to \$304.12 million at September 30, 2011. Changes in stockholders equity during the period were primarily the result of net income available to common shareholders of \$16.80 million, an increase in accumulated other comprehensive income of \$4.22 million, the completion of an \$18.92 million capital raise through the private placement of convertible preferred stock, and the payment of common dividends of \$5.37 million.

**Risk-Based Capital**

Risk-based capital guidelines promulgated by federal banking agencies weight balance sheet assets and off-balance sheet commitments based on inherent risks associated with the respective asset types. The Company's and the Bank's capital ratios as of September 30, 2011, and December 31, 2010, are presented in the following table.

|  | September 30, 2011 | December 31, 2010 |
|--|--------------------|-------------------|
| <b>Total Capital to Risk-Weighted Assets</b>       |                    |                   |
| First Community Bancshares, Inc.                   | 17.94%             | 15.33%            |
| First Community Bank, N. A.                        | 15.69%             | 14.18%            |
| <b>Tier 1 Capital to Risk-Weighted Assets</b>      |                    |                   |
| First Community Bancshares, Inc.                   | 16.68%             | 14.07%            |
| First Community Bank, N. A.                        | 14.43%             | 12.92%            |
| <b>Tier 1 Capital to Average Assets (Leverage)</b> |                    |                   |
| First Community Bancshares, Inc.                   | 11.26%             | 9.44%             |
| First Community Bank, N. A.                        | 9.71%              | 8.66%             |

At September 30, 2011, the Bank was deemed well capitalized under regulatory capital adequacy standards.

**Liquidity and Capital Resources**

At September 30, 2011, the Company maintained liquidity in the form of cash and cash equivalent balances of \$148.32 million, unpledged securities available-for-sale of \$157.07 million, and total FHLB credit availability of approximately \$160.71 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 is a holding company, which is a separate legal entity from the Bank, and at September 30, 2011, maintained cash balances of \$20.79 million. The principal source of the Company's income is dividends from the Bank, which are subject to regulatory restrictions and limitations. As a result of investment securities impairments in 2009, the Bank is limited as to the dividends it can pay to the Company. Accordingly, the Bank would need permission from the Virginia Bureau of Financial Institutions and the Federal Reserve prior to paying dividends to the Company. The cash reserves and investments held by the Company, as well as management fee arrangements provide adequate working capital to meet its obligations and projected dividends to shareholders for the next twelve months and through the projected period of dividend restrictions.

The Company maintains a liquidity policy as a means to manage liquidity and the associated risk. The policy includes a Liquidity Contingency Plan (the Liquidity Plan) that is designed as a tool for the Company to detect liquidity issues promptly in order to protect depositors, creditors

and shareholders. The Liquidity Plan includes monitoring various internal and external indicators such as changes in core deposits and changes in market conditions. It provides for timely responses to a wide variety of funding scenarios ranging from changes in loan demand to a decline in the Company's quarterly earnings to a decline in the market price of the Company's stock. The Liquidity Plan calls for specific responses designed to meet a wide range of liquidity needs based upon assessments on a recurring basis by the Company and its Board of Directors.

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**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk  
Interest Rate Risk and Asset/Liability Management**

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

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

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

The Company has established policy limits for tolerance of interest rate risk 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. At September 30, 2011, modeling indicates that the Company is in a relatively neutral position with respect to sensitivity to interest rate changes.

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The following table summarizes the projected impact on the next twelve months net interest income and the economic value of equity as of September 30, 2011, and December 31, 2010, of immediate and sustained rate shocks in the interest rate environments of plus 300 to minus 100 basis points from the base case rate simulation, assuming no remedial measures are effected. At September 30, 2011, the Federal Open Market Committee maintained a target range for federal funds of 0 to 25 basis points, rendering complete downward shocks greater than 100 basis points unrealistic and not meaningful. In the downward rate shocks presented, benchmark interest rates are dropped with floors near 0%.

Changes in net interest income projected at December 31, 2010, compared to September 30, 2011, are primarily a result of a shifting mix in deposits and other funding. The Company has decreased the size of its certificate of deposit portfolio and increased the size of its transaction and savings oriented deposit portfolios. Additionally, the prepayment of the \$25.00 million FHLB advance provided for significantly reduced interest expense, as the prepayment was funded with cash on hand.

**Rate Sensitivity Analysis****September 30, 2011***(Dollars in Thousands)*

| Increase (Decrease) in               | Change in<br>Net Interest<br>Income | Percent<br>Change | Change in<br>Economic Value<br>of Equity | Percent<br>Change |
|--------------------------------------|-------------------------------------|-------------------|--|-------------------|
| <b>Interest Rates (Basis Points)</b> |                                     |                   |  |                   |
| 300                                  | \$ 4,022                            | 5.7               | \$ 17,376                                | 5.7               |
| 200                                  | 2,633                               | 3.7               | 17,113                                   | 5.6               |
| 100                                  | 1,391                               | 2.0               | 12,806                                   | 4.2               |
| (100)                                | (925)                               | (1.3)             | (31,002)                                 | (10.2)            |

**December 31, 2010***(Dollars in Thousands)*

| Increase (Decrease) in               | Change in<br>Net Interest<br>Income | Percent<br>Change | Change in<br>Economic Value<br>of Equity | Percent<br>Change |
|--------------------------------------|-------------------------------------|-------------------|--|-------------------|
| <b>Interest Rates (Basis Points)</b> |                                     |                   |  |                   |
| 300                                  | \$ 932                              | 1.2               | \$ (10,634)                              | (3.6)             |
| 200                                  | 121                                 | 0.2               | (1,530)                                  | (0.5)             |
| 100                                  | 329                                 | 0.4               | 4,734                                    | 1.6               |
| (100)                                | (105)                               | (0.1)             | (21,503)                                 | (7.3)             |

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

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### **ITEM 4. Controls and Procedures** **Disclosure Controls and Procedures**

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ( CEO ) along with the Company's Chief Financial Officer ( CFO ), of the effectiveness of the Company's disclosure controls and procedures pursuant to the Securities Exchange Act of 1934 ( Exchange Act ) Rule 13a-15(b). Based on that evaluation, the Company's CEO along with the Company's CFO concluded that the Company's disclosure controls and procedures were effective as of September 30, 2011, in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

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

### **Changes in Internal Control over Financial Reporting**

The Company assesses the adequacy of its internal control over financial reporting quarterly and enhances its controls in response to internal control assessments and internal and external audit and regulatory recommendations. There were no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2011, that have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

The Company is currently a defendant in various legal actions and asserted claims in the normal course of business. Although the Company and legal counsel are unable to assess the ultimate outcome of each of these matters with certainty, they are of the belief that the resolution of these actions should not have a material adverse effect 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 previously disclosed under Item 1A. of the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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

- (a) Not Applicable
  
- (b) Not Applicable
  
- (c) Issuer Purchases of Equity Securities



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The following table provides information with respect to purchases made by or on behalf of the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934) of the Company's Common Stock during the third quarter of 2011.

|                      | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>per<br/>Share</b> | <b>Total Number<br/>of<br/>Shares<br/>Purchased as<br/>Part of a Publicly<br/>Announced<br/>Plan</b> | <b>Maximum<br/>Number of<br/>Shares That May<br/>Yet be Purchased<br/>Under the<br/>Plan (1)</b> |
|----------------------|---|---|--|--|
| July 1-30, 2011      |   | \$  |  | 935,002  |
| August 1-31, 2011    | 42,710  | 10.58   | 42,710   | 892,292  |
| September 1-30, 2011 | 5,600   | 10.60   | 5,600  | 886,692  |
| Total                | 48,310  | \$ 10.58  | 48,310   |  |

(1) The Company's stock repurchase plan, as amended, allows the purchase and retention of up to 1,100,000 shares. The plan has no expiration date, remains open and no plans have expired during the reporting period covered by this table. No determination has been made to terminate the plan or to cease making purchases. The Company held 213,308 shares in treasury at September 30, 2011.

**ITEM 3. Defaults Upon Senior Securities**

Not Applicable

**ITEM 4. Reserved****ITEM 5. Other Information**

Not Applicable

**ITEM 6. Exhibits**

(a) Exhibits

**Exhibit**

| <b>No.</b> | <b>Exhibit</b>   |
|------------|--|
| 3(i)       | Articles of Incorporation of First Community Bancshares, Inc. (1)                              |
| 3(ii)      | Bylaws of First Community Bancshares, Inc., as amended. (17)                                   |
| 3.1        | Reserved.  |
| 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) |

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|          |   |
|----------|---|
| 4.4      | Preferred Securities Guarantee Agreement dated September 25, 2003. (11)   |
| 4.5      | Certificate of Designation of 6.00% Series A Noncumulative Convertible Preferred Stock. (21)  |
| 4.6      | Warrant to purchase 88,273 shares of Common Stock of First Community Bancshares, Inc. (29)  |
| 4.7      | Reserved.   |
| 4.8      | Reserved.   |
| 10.1**   | First Community Bancshares, Inc. 1999 Stock Option Contracts (2) and Plan. (4)  |
| 10.1.1** | Amendment to First Community Bancshares, Inc. 1999 Stock Option Plan, as amended. (18)  |
| 10.2**   | First Community Bancshares, Inc. 2001 Non-Qualified Directors Stock Option Plan. (5)  |
| 10.3**   | Amended and Restated Employment Agreement dated December 16, 2008, between First Community Bancshares, Inc. and John M. Mendez (6) and Waiver Agreement. (27) |
| 10.4**   | First Community Bancshares, Inc. 2000 Executive Retention Plan (24) and Amendment #1. (28)  |
| 10.5**   | First Community Bancshares, Inc. Split Dollar Plan and Agreement. (8)   |
| 10.6**   | First Community Bancshares, Inc. 2001 Directors Supplemental Retirement Plan, as amended. (22)  |
| 10.7**   | First Community Bancshares, Inc. Wrap Plan. (7)   |
| 10.9**   | Form of Indemnification Agreement between First Community Bancshares, Inc., its Directors and Certain Executive Officers. (9)                                 |

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|            |  |
|------------|--|
| 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 Form of Award Agreement. (13)   |
| 10.14**    | First Community Bancshares, Inc. Directors Deferred Compensation Plan. (7)   |
| 10.16**    | Employment Agreement dated November 30, 2006, between First Community Bank, N. A. and Ronald L. Campbell. (19)   |
| 10.18      | Securities Purchase Agreement by and between the United States Department of the Treasury and First Community Bancshares, Inc. dated November 21, 2008. (30)                   |
| 10.19**    | Employment Agreement dated December 16, 2008, between First Community Bancshares, Inc. and David D. Brown. (23)  |
| 10.20**    | Employment Agreement dated December 16, 2008, between First Community Bancshares, Inc. and Robert L. Buzzo. (26)   |
| 10.21**    | Employment Agreement dated December 16, 2008, between First Community Bancshares, Inc. and E. Stephen Lilly. (26)  |
| 10.22**    | Employment Agreement dated December 16, 2008, between First Community Bank, N. A. and Gary R. Mills. (26)  |
| 10.23**    | Employment Agreement dated December 16, 2008, between First Community Bank, N. A. and Martyn A. Pell. (26)   |
| 10.24**    | Employment Agreement dated December 16, 2008, between First Community Bank, N. A. and Robert L. Schumacher. (26)   |
| 10.25**    | Employment Agreement dated July 31, 2009, between First Community Bank, N. A. and Simpson O. Brown. (25)   |
| 10.26**    | Employment Agreement dated July 31, 2009, between First Community Bank, N. A. and Mark R. Evans. (25)  |
| 11         | Statement regarding computation of earnings per share. (16)  |
| 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 Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS*** | XBRL Instance Document #   |
| 101.SCH*** | XBRL Taxonomy Extension Schema Document #  |
| 101.CAL*** | XBRL Taxonomy Extension Calculation Linkbase Document #  |
| 101.LAB*** | XBRL Taxonomy Extension Label Linkbase Document #  |
| 101.PRE*** | XBRL Taxonomy Extension Presentation Linkbase Document #   |
| 101.DEF*** | XBRL Taxonomy Extension Definition Linkbase Document #   |

In accordance with Rule 406T of SEC Regulation S-T, the XBRL related documents in Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2011 are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under these Sections.

\* Furnished herewith.

\*\* Indicates a management contract or compensation plan.

\*\*\* Submitted electronically herewith.

# Attached as Exhibit 101 to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2011 of First Community Bancshares, Inc. are the following documents formatted in XBRL (eXtensive Business Reporting Language): (i) Consolidated Balance Sheets (unaudited) at September 30, 2011 and December 31, 2010; (ii) Consolidated Statements of Income (unaudited) for the three and nine months ended September 30, 2011 and 2010; (iii) Consolidated Statement of Stockholders Equity (unaudited) for the nine months ended September 30, 2011; (ix) Condensed Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30,

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2011 and 2010; and (v) Notes to the Unaudited Consolidated Financial Statements.

- (1) Incorporated by reference from Exhibit 3(i) of the Quarterly Report on Form 10-Q for the period dated June 30, 2010, and filed August 16, 2010.
- (2) Incorporated by reference from Exhibit 10.5 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
- (3) Incorporated by reference from Exhibit 4.1 of the Annual Report on Form 10-K for the period ended December 31, 2002, filed on March 25, 2003, as amended on March 31, 2003.
- (4) Incorporated by reference from 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) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated and filed December 16, 2008. The Registrant has entered into substantially identical agreements with Robert L. Buzzo and E. Stephen Lilly, with the only differences being with respect to title and salary.
- (7) Incorporated by reference from the Current Report on Form 8-K dated August 22, 2006, and filed August 23, 2006.
- (8) Incorporated by reference from Exhibit 10.5 of the Annual Report on Form 10-K for the period ended December 31, 1999, and filed on April 4, 2000, and amended on April 13, 2000.
- (9) Form of indemnification agreement entered into by the Company and by First Community Bank, N. A. with their respective directors and certain officers of each including, for the Registrant and Bank: John M. Mendez, Robert L. Schumacher, Robert L. Buzzo, E. Stephen Lilly, David D. Brown, and Gary R. Mills. Incorporated by reference from 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 15, 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.

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- (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 Exhibit 10.13 of 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.
- (15) Incorporated by reference from the Current Report on Form 8-K dated October 24, 2006, and filed October 25, 2006.
- (16) Incorporated by reference from Note 1 of the Notes to Consolidated Financial Statements included herein.
- (17) Incorporated by reference from Exhibit 3.1 of the Current Report on Form 8-K dated February 14, 2008, filed on February 20, 2008.
- (18) Incorporated by reference from Exhibit 10.1.1 of the Quarterly Report on Form 10-Q for the period ended March 31, 2004, filed on May 7, 2004.
- (19) Incorporated by reference from Annex A of Exhibit 2.1 of the Form S-3 registration statement filed May 2, 2007.
- (20) Incorporated by reference from Exhibit 99.1 of the Current Report on Form 8-K dated June 28, 2011, and filed June 28, 2011.
- (21) Incorporated by reference from Exhibit 4.1 of the Current Report on Form 8-K dated May 20, 2011, and filed May 23, 2011.
- (22) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated December 16, 2010, and filed December 17, 2010.
- (23) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated and filed December 16, 2008.
- (24) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated December 30, 2008, and filed January 5, 2009.
- (25) Incorporated by reference from Exhibit 2.1 of the Current Report on Form 8-K dated April 2, 2009 and filed April 3, 2009.
- (26) Incorporated by reference from the Current Report on Form 8-K dated and filed July 6, 2009.
- (27) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated December 16, 2010, and filed December 17, 2010.
- (28) Incorporated by reference from Exhibit 10.3 of the Current Report on Form 8-K dated December 16, 2010, and filed December 17, 2010.
- (29) Incorporated by reference from Exhibit 99.3 of the Current Report on Form 8-K dated and filed July 27, 2010.
- (30) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated November 21, 2008, and filed November 24, 2008.

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SIGNATURES

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

First Community Bancshares, Inc.

DATE: November 7, 2011

/s/ John M. Mendez  
John M. Mendez

President & Chief Executive Officer

(Principal Executive Officer)

/s/ David D. Brown  
David D. Brown

Chief Financial Officer

(Principal Accounting Officer)

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**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Exhibit</b>   |
|--------------------|--|
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.   |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.   |
| 32                 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
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