FIRST COMMUNITY BANCSHARES INC /NV/
Form 10-K
March 12, 2007

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

Form 10-K

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

For the fiscal year ended December 31, 2006

Commission file number 000-19297

FIRST COMMUNITY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

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

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

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

Title of Each Class	**Name of Exchange on Which Registered**
Common Stock, $1.00 par value	**NASDAQ Global Select**

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information

statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

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

Approximately $349,395,185 based on the closing sales price at June 30, 2006

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

Class Common Stock, $1.00 Par Value; 11,268,552 shares outstanding as of February 28, 2007

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the annual meeting of shareholders to be held April 24, 2007, are incorporated by reference in Part III of this Form 10-K.

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PART I

ITEM 1. *BUSINESS.*

General

First Community Bancshares, Inc. (the Company) is a one-bank holding company incorporated in the State of Nevada and serves as the holding company for First Community Bank, N. A. (the Bank), a National Association that conducts commercial banking operations within the States of Virginia, West Virginia, North Carolina and Tennessee. The Bank owns Investment Planning Consultants (IPC), an investment advisory firm purchased in November 2006. The Company had total consolidated assets of approximately $2.03 billion at December 31, 2006,and conducts commercial and mortgage banking business through forty-eight full-service banking locations, eight loan production offices, and four trust and investment management offices.

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

Employees

The Company and its subsidiaries employed 602 full-time equivalent employees at December 31, 2006. Management considers employee relations to be excellent.

Regulation and Supervision

General

The supervision and regulation of bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the deposit insurance fund of the FDIC, and the banking system as a whole, and not for the protection of the bank holding company shareholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks, including the power to impose substantial fines and other penalties for violations of laws and regulations.

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

The Company

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (BHCA). Accordingly, the Company is subject to supervision, regulation and examination by the Board of Governors

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

Regulatory Restrictions on Dividends; Source of Strength. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company s ability to serve as a source of strength to its banking subsidiaries.

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

In the event of a bank holding company s bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and is required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution. Any claim for breach of such obligation will generally have priority over most other unsecured claims.

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

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

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

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

Stock Repurchases. A bank holding company is required to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company s consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. A holding company may not impair its subsidiary bank s soundness by causing it to make funds available to nonbanking subsidiaries or their customers if the Federal Reserve Board believes it is not prudent to do so.

Capital Adequacy Requirements. The Federal Reserve Board has promulgated capital adequacy guidelines for use in its examination and supervision of bank holding companies. If a bank holding company s capital falls below minimum required levels, then the bank holding company must implement a plan to increase its capital, and its ability to pay

dividends, make acquisitions of new banks or engage in certain other activities such as issuing brokered deposits may be restricted or prohibited.

The Federal Reserve Board currently uses two types of capital adequacy guidelines for holding companies, a two-tiered risk-based capital guideline and a leverage capital ratio guideline. The two-tiered risk-based capital guideline assigns risk weightings to all assets and certain off-balance sheet items of the holding company s operations, and then establishes a minimum ratio of the holding company s Tier 1 capital to the aggregate dollar amount of risk-weighted assets (which amount is usually less than the aggregate dollar amount of such assets

without risk weighting) and a minimum ratio of the holding company s total capital (Tier 1 capital plus Tier 2 capital, as adjusted) to the aggregate dollar amount of such risk-weighted assets. The leverage ratio guideline establishes a minimum ratio of the holding company s Tier 1 capital to its total tangible assets (total assets less goodwill and certain identifiable intangibles), without risk-weighting.

Under both guidelines, Tier 1 capital (sometimes referred to as core capital) is defined to include: common shareholders equity (including retained earnings), qualifying non-cumulative perpetual preferred stock and related surplus, qualifying cumulative perpetual preferred stock and related surplus, trust preferred securities, and minority interests in the equity accounts of consolidated subsidiaries (limited to a maximum of 25% of Tier 1 capital). Goodwill and most intangible assets are deducted from Tier 1 capital. For purposes of the total risk-based capital guidelines, Tier 2 capital (sometimes referred to as supplementary capital) is defined to include: allowances for loan and lease losses (limited to 1.25% of risk-weighted assets), perpetual preferred stock not included in Tier 1 capital, intermediate-term preferred stock and any related surplus, certain hybrid capital instruments, perpetual debt and mandatory convertible debt securities, and intermediate-term subordinated debt instruments (subject to limitations). The maximum amount of qualifying Tier 2 capital is 100% of qualifying Tier 1 capital. For purposes of the total capital guideline, total capital equals Tier 1 capital, *plus* qualifying Tier 2 capital, *minus* investments in unconsolidated subsidiaries, reciprocal holdings of bank holding company capital securities, and deferred tax assets and other deductions. The Federal Reserve Board s current capital adequacy guidelines require that a bank holding company maintain a Tier 1 risk-based capital ratio of at least 4% and a total risk-based capital ratio of at least 8%. At December 31, 2006, the Company s ratio of Tier 1 capital to total risk-weighted assets was 11.60% and its ratio of total capital to risk-weighted assets was 12.69%.

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company s Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of 4.0% or more, depending on their overall condition. At December 31, 2006, the Company s leverage ratio was 8.50%.

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

Acquisitions by Bank Holding Companies. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors.

The Bank

The Bank is a national banking association. As a national banking association, the Bank is subject to supervision and regulation by the Office of the Comptroller of Currency (OCC). Since the deposits of the Bank are insured by the

Federal Deposit Insurance Corporation (FDIC), the Bank is are also subject to supervision and regulation by the FDIC. Because the Federal Reserve Board regulates the Company, and because the Bank is a member of the Federal Reserve System, the Federal Reserve Board also has regulatory authority which directly affects the Bank.

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

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

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

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

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

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

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

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

The OCC s risk-based capital guidelines generally require national banks to have a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for the Bank as for the Company. At December 31, 2006, the Bank s ratio of Tier 1 capital to total risk-weighted assets was 10.73% and its ratio of total capital to total risk-weighted assets was 11.77%.

The OCC s leverage guidelines require national banks to maintain Tier 1 capital of no less than 4.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets. At December 31, 2006, the Bank s leverage ratio was 7.85%.

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

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

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

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

Deposit Insurance Assessments. The Bank s deposits are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The DIF was created by the merger of the Bank Insurance Fund and Savings Association Insurance Fund provided for in the Federal Deposit Insurance Reform Act of 2005 (FDIRA), as enacted in February 2006. On November 2, 2006, the FDIC adopted final regulations implementing the FDIRA, which established a risk-based assessment system that will enable the FDIC to more closely tie each financial institution s premiums to the risk it poses to the deposit insurance fund. Under the new risk-based assessment system, which became effective January 1, 2007, the FDIC will evaluate the risk of each financial institution based on three primary sources of information: (1) its supervisory rating, (2) its financial ratios, and (3) its long-term debt issuer rating, if the institution has one. The FDIC also adopted a new base schedule of rates that it can adjust up or down, depending on the needs of the DIF, and set initial premiums for 2007 that range from 5 cents per $100 of domestic deposits in the lowest risk category to 43 cents per $100 of domestic deposits for banks in the highest risk category. The FDIC regulations designated the reserve ratio for the DIF during 2007 at 1.25% of estimated insured deposits.

The FDIRA also provides for a one-time assessment credit for eligible insured depository institutions (those institutions that were in existence on December 31, 1996 and paid a deposit insurance assessment prior to that date, or are a successor to any such institution). The credit is determined based on the assessment base of the institution as of December 31, 1996 as compared with the combined aggregate assessment base of all eligible institutions as of that date. The credit may be used to offset up to 100% of the 2007 DIF assessment, and if not completely used in 2007, may be applied to not more than 90% of each of the aggregate 2008, 2009 and 2010 DIF assessments.

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

Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, and the Fair Housing Act, and various state counterparts. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

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

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

Website Access to Company Reports

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

Forward-Looking Statements

This Annual Report on Form 10-K may include forward-looking statements , which are made in good faith by the Company pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements with respect to the Company s beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates and intentions that are subject to significant

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

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

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

ITEM 1A. *RISK FACTORS.*

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

We are unable to predict actual fluctuations of market interest rates with complete accuracy. Rate fluctuations are affected by many factors, including inflation, recession, a rise in unemployment, a tightening of the money supply and domestic and international disorder and instability in domestic and foreign financial markets.

Changes in the interest rate environment may reduce profits. We expect that the Company and the Bank will continue to realize income from the differential or spread between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. Changes in levels of market interest rates could materially and adversely affect the Company s net interest spread, levels of prepayments and cash flows, the market value of its securities portfolio, and overall profitability.

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

The Company is a separate legal entity from the Bank and its subsidiaries and does not have significant operations of its own. The Company currently depends on the Bank s cash and liquidity as well as dividends to pay the Company s operating expenses and dividends to shareholders. No assurance can be made that in the future the Bank will have the capacity to pay the necessary dividends and that the Company will not require dividends from the Bank to satisfy the

Company s obligations. The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Bank and other factors that the OCC, the Bank s primary regulator, could assert that payment of dividends or other payments by the Bank are an unsafe or unsound practice. In the event the Bank is unable to pay dividends sufficient to satisfy the Company s

obligations or is otherwise unable to pay dividends to the Company, the Company may not be able to service its obligations as they become due, including payments required to be made to the FCBI Capital Trust, a business trust subsidiary of the Company, or pay dividends on the Company s common stock. Consequently, the inability to receive dividends from the Bank could adversely affect the Company s financial condition, results of operations, cash flows and prospects.

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

Like all financial institutions, the Bank maintains an allowance for loan losses to provide for probable losses. The Bank s allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses could materially and adversely affect the Bank s operating results. The Bank s allowance for loan losses is determined by analyzing historical loan losses, current trends in delinquencies and charge-offs, plans for problem loan resolution, changes in the size and composition of the loan portfolio, and industry information. Also included in management s estimates for loan losses are considerations with respect to the impact of economic events, the outcome of which are uncertain. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond the Bank s control, and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review the Bank s loans and allowance for loan losses. While we believe that the Bank s allowance for loan losses is adequate to provide for probable losses, we cannot assure you that we will not need to increase the Bank s allowance for loan losses or that regulators will not require us to increase this allowance. Either of these occurrences could materially and adversely affect the Bank s earnings and profitability.

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

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

- loan delinquencies may increase;
- problem assets and foreclosures may increase;
- demand for the Company s products and services may decline; and
- collateral for loans made by the Company may decline in value, in turn reducing a client s borrowing power, and reducing the value of assets and collateral associated with the Company s loans held for investment.

A downturn in the real estate market could hurt the Company s business.

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

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

Commercial business and commercial real estate loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial business and commercial real estate loans involve risks because the borrower s ability to repay the loan typically

depends primarily on the successful operation of the business or the property securing the loan. Most of the commercial business loans are made to small business or middle market customers who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made or acquired by the Company in the last several years and the borrowers may not have experienced a complete business or economic cycle.

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

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

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

The Company and its subsidiaries operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of the Company s operations. The Company believes that it is in substantial compliance in all material respects with applicable federal, state and local laws, rules and regulations. Because the Company s business is highly regulated, the laws, rules and regulations applicable to it are subject to regular modification and change. There are various laws, rules and regulations that impact the Company s operations, including, among other things, matters pertaining to corporate governance, requirements for listing and maintenance on national securities exchanges and over the counter markets, Securities and Exchange Commission (SEC) rules pertaining to public reporting disclosures and banking regulations governing the amount of loans that a financial institution, such as the Bank, can acquire for investment from an affiliate. In addition, the Financial Accounting Standards Board (FASB) made changes which require, among other things, the expensing of the fair value of stock options. These laws, rules and regulations, or any other laws, rules or regulations, that may be adopted in the future, could make compliance more difficult or expensive, restrict the Company s ability to originate, broker or sell loans, further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by the Bank and otherwise adversely affect the Company s business, financial condition or prospects.

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

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

Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger clients. These institutions, particularly to the extent they are more diversified than the Company, may be able to offer the

same loan products and services that the Company offers at more competitive rates and prices. If the Company is unable to attract and retain banking clients, the Company may be unable to continue the Bank s loan and deposit growth and the Company s business, financial condition and prospects may be negatively affected.

ITEM 1B. ***UNRESOLVED STAFF COMMENTS.***

The Company has no unresolved staff comments as of the filing date of this 2006 Annual Report on Form 10-K.

ITEM 2. ***PROPERTIES.***

The Company generally owns its offices, related facilities, and unimproved real property. The principal offices of the Company are located at One Community Place, Bluefield, Virginia, where the Company owns and occupies approximately 36,000 square feet of office space. The Bank operates forty-eight full-service branches and eight loan production offices throughout the four-state region of Virginia, West Virginia, North Carolina and Tennessee. The Bank also provides wealth management services through two trust and investment management offices, as well as Investment Planning Consultants, an investment advisory firm, which has two offices. The Company s banking subsidiary owns forty of its banking offices while others are leased or are located on leased land. There are no mortgages or liens against any property of the Bank or the Company.

In Virginia, the Bank operates offices in Blacksburg, Bluefield, Clintwood, Emporia, Max Meadows, Pound, Richlands, Richmond, Tazewell, and Wytheville. In West Virginia, the Bank operates offices in Athens, Beckley, Bluefield, Bridgeport, Buckhannon, Cowen, Craigsville, Grafton, Hinton, Lindside, Man, Mullens, Oceana, Pineville, Princeton, Richwood, Summersville, and Teays Valley. In North Carolina, the Bank operates offices in Charlotte, Elkin, Hays, Mount Airy, Sparta, Taylorsville, and Winston-Salem. In Tennessee, the Bank operates offices in Boones Creek, Fall Branch, Johnson City, Kingsport, and Piney Flats. A complete listing of all branches and ATM sites can be found on the Internet at www.fcbresource.com. Information on such website is not part of this Annual Report on Form 10-K.

ITEM 3. ***LEGAL PROCEEDINGS.***

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

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

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

PART II

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

The number of common stockholders of record on December 31, 2006,was 2,548 and outstanding shares totaled 11,245,742. The number of common stockholders is measured by the number of recordholders.

The Company s common stock trades on the NASDAQ Global Select market under the symbol FCBC. On December 31, 2006, the Company s year-end common stock price was $39.56, a 27.0% increase from the $31.16 closing price on December 31, 2005.

Book value per common share was $18.92 at December 31, 2006, compared with $17.29 at December 31, 2005, and $16.29 at the close of 2004. The year-end market price for the Company s common stock of $39.56 represents 209.1% of the Company s book value as of the close of the year and reflects total market capitalization of $444.9 million. Utilizing the year-end market price and 2006 diluted earnings per share, the Company s common stock closed the year trading at a price/earnings multiple of 15.4 times diluted earnings per share.

Cash dividends for 2006 totaled $1.04 per share, up $0.02 or 2.0% from the $1.02 paid in 2005. The 2006 dividends resulted in a cash yield on the year-end market value of 2.63%. Total dividends paid for the current and prior years totaled $11.7 million and $11.5 million, respectively.

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

	High	Low	Book Value Per Share (End of Period)	Cash Dividends Per Share
2006				
First Quarter	$ 35.27	$ 30.16	$ 17.49	$ 0.26
Second Quarter	33.00	29.50	17.71	0.26
Third Quarter	34.44	30.04	18.40	0.26
Fourth Quarter	41.17	31.67	18.92	0.26
				$ 1.04
2005				
First Quarter	$ 36.21	$ 27.39	$ 16.35	$ 0.255
Second Quarter	33.20	26.25	16.83	0.255
Third Quarter	34.25	28.02	17.15	0.255
Fourth Quarter	33.71	27.14	17.29	0.255
				$ 1.02

The Company s stock repurchase plan, as amended, allows the purchase and retention of up to 550,000 shares. The plan has no expiration date, remains open and no plans have expired during the reporting period. No determination has been made to terminate the plan or to stop making purchases. The following table sets forth open market purchases by the Company of its equity securities during 2006. The repurchase of Company stock has the effect of increasing earnings per share. During 2006, the weighted-average increase in the number of treasury shares had an insignificant impact on earnings per share.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan
January 1-31, 2006	23,161	$ 32.10	23,161	284,455
February 1-29, 2006	32,900	32.14	32,900	287,234
March 1-31, 2006	25,000	31.81	25,000	265,566
April 1-30, 2006	10,000	30.38	10,000	255,566
May 1-31, 2006	14,300	30.68	14,300	248,337

June 1-30, 2006	25,500	30.85	25,500	227,437
July 1-31, 2006	14,300	30.84	14,300	215,756
August 1-31, 2006				234,650
September 1-30, 2006				234,650
October 1-31, 2006				242,871
November 1-30, 2006				296,224
December 1-31, 2006				296,724
Total	145,161	$ 31.46	145,161	

In November 2006, the Company completed the acquisition of Investment Planning Consultants, Inc. (IPC), a registered investment advisory firm. In connection with the initial payment of approximately $1.47 million, the Company issued 39,874 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of IPC are entitled to additional consideration of $1.43 million in the form of the Company s common stock if certain future operating performance targets are met.

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Total Return Analysis

The following chart was compiled by SNL Securities, LC, and compares cumulative total shareholder return of the Company s Common Stock for the five-year period ended December 31, 2006, with the cumulative total return of the NASDAQ Composite index and the Asset Size & Regional Peer Group. The Asset Size & Regional Peer Group consists of 42 bank holding companies that are traded on the NASDAQ, OTC Bulletin Board, and pink sheets with total assets between $1 billion and $5 billion and are located in the southeast region of the United States. The cumulative returns include payment of dividends by the Company.

Total Return Performance

	Period Ending					
Index	**12/31/01**	**12/31/02**	**12/31/03**	**12/31/04**	**12/30/05**	**12/31/06**
First Community Bancshares, Inc.	100.00	118.64	144.89	162.66	145.22	190.26
NASDAQ Composite	100.00	68.76	103.67	113.16	115.57	127.58
Asset Size & Regional Peer Group	100.00	128.61	174.02	208.63	212.50	238.47

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ITEM 6. ***SELECTED FINANCIAL DATA.***

Five-Year Selected Financial Data	2006	2005	2004	2003	2002
	At or for the Year Ended December 31, (Amounts in thousands)				
Balance Sheet Summary (at end of period)					
Securities(a)	$ 528,389	$ 428,554	$ 410,218	$ 473,177	$ 334,018
Loans held for sale	781	1,274	1,194	424	865
Loans, net of unearned income	1,284,863	1,331,039	1,238,756	1,026,191	927,621
Allowance for loan losses	14,549	14,736	16,339	14,624	14,410
Assets related to discontinued operations				22,372	71,631
Total assets	2,033,698	1,952,483	1,830,822	1,672,727	1,524,363
Deposits	1,394,771	1,403,220	1,356,719	1,223,376	1,137,816
Borrowings	406,556	335,885	274,212	242,267	156,823
Liabilities related to discontinued operations				17,992	65,519
Total liabilities	1,820,968	1,757,982	1,647,589	1,497,692	1,371,901
Stockholders equity	212,730	194,501	183,233	175,035	152,462
Summary of Earnings					
Total interest income	$ 120,026	$ 109,508	$ 96,136	$ 90,641	$ 92,580
Total interest expense	48,381	35,880	26,953	26,397	32,299
Provision for loan losses	2,706	3,706	2,671	3,419	4,208
Non-interest income	21,323	22,305	17,329	14,542	10,617
Non-interest expense	49,837	55,591	48,035	37,590	32,720
Income from continuing operations before income taxes	40,425	36,636	35,806	37,777	33,970
Income tax expense	11,477	10,191	9,786	11,058	9,740
Income from continuing operations	28,948	26,445	26,020	26,719	24,230
(Loss) income from discontinued operations before income taxes		(233)	(5,746)	(2,174)	798
Income tax (benefit) expense		(91)	(2,090)	(693)	309
(Loss) income from discontinued operations		(142)	(3,656)	(1,481)	489
Net income	28,948	26,303	22,364	25,238	24,719

(a) Reflects the reclassification during the 2002-2004 periods of Federal Reserve Bank and Federal Home Loan Bank stock from Securities Available for Sale to Other Assets, consistent with the 2005 and 2006 presentation.

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Five-Year Selected Financial Data	At or for the Year Ended December 31, 2006	2005	2004	2003	2002
Per Share Data					
Basic earnings per share	$ 2.58	$ 2.33	$ 1.99	$ 2.27	$ 2.26
Basic earnings per common share continuing operations	2.58	2.35	2.32	2.41	2.22
Basic (loss) earnings per common share discontinued operations		(0.02)	(0.33)	(0.14)	0.04
Diluted earnings per common share	$ 2.57	$ 2.32	$ 1.97	$ 2.25	$ 2.25
Diluted earnings per common share continuing operations	2.57	2.33	2.29	2.39	2.21
Diluted (loss) earnings per common share discontinued operations		(0.01)	(0.32)	(0.14)	0.04
Cash dividends	$ 1.04	$ 1.02	$ 1.00	$ 0.98	$ 0.91
Book value at year-end	$ 18.92	$ 17.29	$ 16.29	$ 15.57	$ 14.02
Selected Ratios					
Return on average assets	1.46%	1.37%	1.24%	1.56%	1.68%
Return on average assets-continuing	1.46%	1.38%	1.45%	1.70%	1.72%
Return on average equity	14.32%	13.79%	12.53%	15.13%	17.16%
Return on average equity-continuing	14.32%	13.87%	14.58%	16.02%	16.82%
Average equity to average assets	10.21%	9.91%	9.88%	10.32%	9.79%
Average equity to average assets-continuing	10.21%	9.91%	9.96%	10.64%	10.22%
Dividend payout	40.31%	43.78%	50.25%	43.17%	40.16%
Risk based capital to risk adjusted assets	12.69%	11.65%	12.09%	14.55%	13.33%
Leverage ratio	8.50%	7.77%	7.62%	8.83%	8.10%

ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.*

This discussion should be read in conjunction with the consolidated financial statements, notes and tables included throughout this report. All statements other than statements of historical fact included in this report, including statements in this Management s Discussion and Analysis of Financial Condition and Results of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act. As discussed below, the financial statements, footnotes, schedules and discussion within this report have been reformatted to conform to the presentation required for discontinued operations pursuant to the Company s sale of its mortgage banking subsidiary.

Executive Overview

First Community Bancshares, Inc. is a bank holding company which provides commercial banking services and has positioned itself as a regional community bank and a financial services alternative to larger banks which often provide less emphasis on personal relationships, and smaller community banks which lack the capital and resources to efficiently serve customer needs. The Company has focused its growth efforts on building financial partnerships and more enduring and complete relationships with businesses and individuals through a very personal approach to banking and financial services. The Company and its operations are guided by a strategic plan which includes growth through acquisitions and through office expansion in new market areas including strategically identified metro

markets in Virginia, West Virginia, North Carolina and Tennessee. While the Company s mission remains that of a community bank, management believes that entry into new markets will accelerate the Company s growth rate by diversifying the demographics of its customer base and customer prospects and by generally increasing its sales and service network.

Economy

Throughout 2006, short-term market interest rates increased, while long-term market rates remained largely unchanged. Those changes have resulted in an inverted interest rate curve, an environment that has led to increased compression of net interest margins.

The local economies in which the Company operates are diverse and cover the majority portion of a four state region. West Virginia and Southwest Virginia continue to benefit from increasing crude oil prices. These economies have significant exposure to extractive industries, such as coal and natural gas, which become more active and lucrative when oil prices rise. The local economies in the central portion of North Carolina have suffered in recent years due to foreign competition in both furniture and textiles as well as consolidation in the financial services industry. Despite these detractions, the economies in this region continue to benefit from strong real estate development, good commercial occupancy rates and national companies relocating and expanding in the Triad and Central Piedmont areas. The Eastern Virginia local economies are experiencing strong growth in residential and commercial development as those areas continue to benefit from a wide array of corporate activities and relocations.

Competitive Focus

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

Application of Critical Accounting Policies

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

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

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

Allowance for Loan Losses

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

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

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

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

Acquisitions and Intangible Assets

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

Management must also make estimates of useful or economic lives of certain acquired assets and liabilities. These lives are used in establishing amortization and accretion of some intangible assets and liabilities, such as the intangible

associated with core deposits acquired in the acquisition of a commercial bank.

Goodwill is recorded as the excess of the purchase price, if any, over the fair value of the revalued net assets. Goodwill is tested annually in the month of November for possible impairment by comparing the fair value of the unit with its book value, including goodwill. If the fair value of the Company is greater than its book value, no goodwill impairment exists. However, if the book value of the Company is greater than its determined fair value, goodwill impairment may exist and further testing is required to determine the amount, if any, of the actual impairment loss. Further testing would use a discounted cash flow model applied to the anticipated stream of cash

flows from operations of the business or segment being tested. Impairment testing necessarily uses estimates in the form of growth and attrition rates, anticipated rates of return, and discount rates. These estimates have a direct bearing on the results of the impairment testing and serve as the basis for management s conclusions as to impairment.

Income Taxes

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

Recent Acquisitions and Branching Activity

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

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

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

In December 2005, the Company completed the sale of its Clifton Forge, Virginia, branch location. The sale included deposits and repurchase agreements totaling approximately $45.3 million and loans of approximately $7.1 million. The transaction resulted in an approximate $4.4 million pre-tax gain on sale.

The Company has plans to open two new branches in Winston-Salem, North Carolina, during the first quarter of 2007. Construction is also under way on branches in Mechanicsville, Virginia, and Daniels and Summersville, West Virginia. Those three branches are expected to be open by the fourth quarter of 2007.

RESULTS OF OPERATIONS

2006 COMPARED TO 2005

Net income for 2006 was $28.9 million, up $2.6 million from $26.3 million in 2005. Basic and diluted earnings per share for 2006 were $2.58 and $2.57, respectively, compared to basic and diluted earnings per share of $2.33 and $2.32, respectively, in 2005.

The Company s key profitability ratios are return on average assets and return on average equity. Returns on average assets for 2006 and 2005 were 1.46% and 1.37%, respectively. The returns on average equity for 2006 and 2005 were 14.32% and 13.79%, respectively. The Company continues to compare favorably to national peer returns of 1.13% and 13.20%, respectively, based on the September 2006 Bank Holding Company Performance Report, prepared by the Federal Reserve.

Net Interest Income

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

Net interest income was $71.6 million for 2006, compared to $73.6 million for 2005. Tax-equivalent net interest income totaled $75.7 million for 2006, a decrease of $2.0 million from the $77.7 million reported for 2005. The decrease is attributable to a $651 thousand decrease due to volume and a $1.4 million decrease due to rate changes on the underlying assets and liabilities.

During 2006, average earning assets increased $23.8 million while average interest-bearing liabilities increased $35.9 million, in each case over the comparable period. The yield on average earning assets increased 50 basis points to 6.92% from 6.42% for 2005. The rate earned on assets was positively impacted by the continued increases in short-term market interest rates throughout 2006.

Total cost of average interest-bearing liabilities increased 76 basis points to 3.17% during 2006, as liabilities were also affected by increases in short-term market interest rates. The net result was a decrease of 26 basis points to net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities. Spread for 2006 was 3.75% compared to 4.01% for 2005. The Company s tax-equivalent net interest margin of 4.22% for 2006 was a decrease of 17 basis points from 4.39% in 2005.

The largest contributor to the increase in the yield on average earning assets in 2006, on a volume-weighted basis, was a 50 basis point increase in the rate earned on loans held for investment. The increase in rate contributed approximately $6.5 million to the $7.5 million change in interest income from the portfolio. The yield on variable-rate loans tied to prime and other indices increased in response to the recent increases in short-term interest rates.

During 2006, the tax-equivalent yield on available for-sale securities increased 52 basis points to 5.50% while the average balance increased by $21.6 million. The average tax-equivalent yield increased due to the addition of higher-rate securities and the sales, maturities, and calls of lower-rate securities.

Average interest-bearing balances with banks declined $4.8 million during 2006 to $27.3 million, while the yield increased 120 basis points to 4.56%. The yield on those balances is directly correlated to the increases in the target federal funds rate which occurred throughout the year.

The Company attempts to control the cost of deposited funds in relation to the prevailing economic climate and competitive forces. The Company determines its overall balance sheet management goals through its Asset/Liability Management Committee. Throughout 2006, the pressures of increasing short-term interest rates resulted in an increase of 86 basis points in the average cost of interest-bearing deposits. The average rate paid on interest-bearing demand deposits increased 6 basis points, while the average rate paid on savings, which includes money market and passbook accounts, increased 82 basis points. The Company was successful in keeping rates paid on interest-bearing checking accounts relatively stable and increased money market account rates to remain competitive and retain deposit funding. Average time deposits increased $21.9 million while the average rate paid increased 96 basis points to 3.88%. The level of average non-interest-bearing demand deposits increased $8.9 million to $237.7 million compared to the prior year.

Average federal funds purchased and repurchase agreements increased $22.3 million, due mostly to increases in the balances of repurchase agreements. The average rate paid on those funds also increased, as they are closely tied to the target federal funds rate. Average Federal Home Loan Bank (FHLB) advances increased $22.7 million while interest paid on those borrowings decreased 56 basis points as the Company repositioned its FHLB borrowings, and took advantage of lower interest rate borrowing products. In January of 2006, the Company borrowed $75 million from the FHLB. At the same time, the Company entered into a $50 million pay fixed, receive variable interest rate swap, effectively fixing the borrowing rate at approximately 4.34%. Other borrowings

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remained steady, but the rate paid increased 176 basis points because the majority of such borrowings consist of the Company’s trust preferred borrowing, which is tied to LIBOR.

Average Balance Sheets and Net Interest Income Analysis

	2006			2005			2004	
	Average Balance	**Interest(1)**	**Yield/ Rate(1)**	**Average Balance**	**Interest(1)**	**Yield/ Rate(1)**	**Average Balance**	**Interest(1)**
				(Dollars in thousands)				
Assets:								
eld for Investment:(2)								
	$ 1,314,976	$ 97,386	7.41%	$ 1,299,328	$ 89,788	6.91%	$ 1,154,166	$ 76,519
mpt	1,499	114	7.61%	2,692	177	6.58%	4,965	297
	1,316,475	97,500	7.41%	1,302,020	89,965	6.91%	1,159,131	76,816
e-for-Sale Securities:								
	276,142	13,929	5.04%	262,715	11,062	4.21%	313,033	12,094
mpt	152,437	9,655	6.33%	144,242	9,193	6.37%	110,904	7,474
	428,579	23,584	5.50%	406,957	20,255	4.98%	423,937	19,568
Maturity Securities:								
	386	22	5.70%	399	15	3.76%	419	25
mpt	20,912	1,686	8.06%	28,336	2,269	8.01%	35,535	2,853
	21,298	1,708	8.02%	28,735	2,284	7.95%	35,954	2,878
bearing deposits with								
	27,289	1,244	4.56%	32,100	1,077	3.36%	32,430	591
funds sold							60	1
rning assets	1,793,641	$ 124,036	6.92%	1,769,812	$ 113,581	6.42%	1,651,512	$ 99,854
sets	186,639			153,410			140,379	
elated to discontinued								
ns							14,950	
	$ 1,980,280			$ 1,923,222			$ 1,806,841	
bearing Liabilities:								
deposits	$ 146,248	$ 462	0.32%	$ 152,774	$ 401	0.26%	$ 149,502	$ 366
deposits	343,854	6,857	1.99%	368,339	4,309	1.17%	366,074	3,112
posits	683,418	26,549	3.88%	661,498	19,321	2.92%	615,346	15,001
funds purchased and								
se agreements	150,839	5,079	3.37%	128,551	2,782	2.16%	109,223	1,405
rrowings and other								
n debt	200,570	9,434	4.70%	177,832	9,068	5.10%	148,384	7,070
erest-bearing								
es	1,524,929	48,381	3.17%	1,488,994	35,881	2.41%	1,388,529	26,954
deposits	237,714			228,781			212,777	

bilities	15,513		14,772		13,980	
s related to ued operations					13,113	
ders equity	202,124		190,675		178,442	
	$ 1,980,280		$ 1,923,222		$ 1,806,841	
est Income		$ 75,655		$ 77,700		$ 72,900
est Rate Spread(3)		3.75%		4.01%		
est Margin(4)		4.22%		4.39%		

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

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

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

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

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Rate and Volume Analysis of Interest

The following table summarizes the changes in interest earned and paid resulting from changes in volume of earning assets and paying liabilities and changes in their interest rates. In this analysis, the change in interest due to both rate and volume has been allocated to the volume and rate columns in proportion to absolute dollar amounts. The table shows (i) the overall decrease in net interest income during 2006 was due to increases in interest expense which outpaced increases in interest income; and (ii) increases in rates earned on assets and paid on liabilities continued to increase in 2006, due primarily to continuing increases in benchmark short-term interest rates. When comparing 2005 to 2004, the table shows (i) the increase in net interest income in 2005 was due largely to increases in earning assets resulting from growth seen in both the consumer and commercial loan portfolios; (ii) increases in both rates earned on assets and paid on liabilities due to increases in benchmark short-term interest rates; and (iii) in 2005, margin compressed slightly as increases to the rates paid on money market accounts and certificates of deposit outpaced increases in the rates received on loans.

	2006 Compared to 2005 $ Increase/(Decrease) due to			2005 Compared to 2004 $ Increase/(Decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Amounts in thousands)					
Interest Earned On(1):						
Loans	$ 1,005	$ 6,530	$ 7,535	$ 9,782	$ 3,367	$ 13,149
Securities available for sale	1,108	2,221	3,329	87	600	687
Securities held to maturity	(599)	23	(576)	(578)	(16)	(594)
Interest-bearing deposits with other banks	(178)	345	167	(6)	492	486
Federal funds sold				(1)		(1)
Total interest-earning assets	1,336	9,119	10,455	9,284	4,443	13,727
Interest Paid On:						
Demand deposits	(18)	79	61	8	27	35
Savings deposits	(304)	2,852	2,548	19	1,178	1,197
Time deposits	660	6,568	7,228	1,186	3,134	4,320
Federal funds purchased and repurchase agreements	546	1,751	2,297	284	1,093	1,377
FHLB borrowings and other long-term debt	1,103	(737)	366	1,443	555	1,998
Total interest-bearing liabilities	1,987	10,513	12,500	2,940	5,987	8,927
Change in net interest income	$ (651)	$ (1,394)	$ (2,045)	$ 6,344	$ (1,544)	$ 4,800

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

Provision for Loan Losses

The provision for loan losses for 2006 was $2.7 million, a decrease of $1.0 million when compared to 2005. The decrease in loan loss provision between the periods is primarily attributable to changes in specific allocations, decreases in commercial and consumer installment loan volume, reductions in net charge-offs, overall improved asset quality, and changes in various qualitative risk factors. Net charge-offs for 2006 and 2005 were $2.9 million and $4.9 million, respectively. Expressed as a percentage of average loans, net charge-offs decreased from 0.38% for 2005 to 0.22% for 2006. During 2005, the Company experienced a loss from a credit to a hospitality concern, which largely accounted for the higher net charge-offs in 2005. The $4.4 million loan was charged down to its net realizable value of $2.2 million, and the note was sold to a third party and the final net loss to the Company was $1.5 million.

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Non-interest Income

Details of non-interest income are summarized in the following table:

	Years Ended December 31,		
	2006	2005	2004
	(Amounts in thousands)		
Wealth management income	$ 2,811	$ 2,956	$ 2,489
Service charges on deposit accounts	10,242	10,095	9,122
Other service charges, commissions and fees	2,992	2,785	2,239
Other operating income	5,203	5,716	1,875
Net gains on sale of securities	75	753	1,604
Total	$ 21,323	$ 22,305	$ 17,329

Non-interest income consists of all revenues which are not included in interest and fee income related to earning assets. Non-interest income for 2006 was $21.3 million compared to $22.3 million in 2005. Wealth management income, which includes fees for trust services and commission and fee income generated by IPC (post-acquisition) and the Company s prior investment advisory subsidiary, whose customer base migrated to IPC in 2006, decreased $145 thousand in 2006, or 4.9%, compared to 2005.

Service charges on deposit accounts increased $147 thousand, or 1.5%, while other service charges, commissions and fees reflected gains of $207 thousand, or 7.4%.

Other operating income includes $1.0 million and $4.4 million in gains from the sale of branch locations in 2006 and 2005, respectively. The remaining components of other operating income increased $2.8 million compared to 2005. The largest single item in that increase is the $976 thousand earned on the Company s $25 million investment in life insurance made in April 2006. Also included in other income for 2006 is a $676 thousand recovery relating to a 1997 payment system fraud loss. During 2006, the Company also recognized securities gains of $75 thousand, which were $678 thousand less than those recognized in 2005.

Non-interest Expense

Total non-interest expense was $49.8 million for 2006, a decrease of $5.8 million over 2005. Salaries and benefits decreased approximately $2.6 million due to the Company s refocused efforts on expense control and efficiency. During 2006, total full-time equivalent employees decreased to 602 from 716 at December 31, 2005. Also contributing to the decrease from year to year was the $3.8 million prepayment penalty incurred in connection with the early termination of $77.0 million of FHLB advances in 2005.

Occupancy and furniture and equipment expenses increased $165 thousand and $147 thousand, respectively, compared to 2005. The general level of occupancy and furniture and equipment costs in 2006 grew largely as a result of increases in depreciation associated with continued investment in facilities, operating equipment, and technology infrastructure.

All other operating expense accounts increased $367 thousand, or less than 3%, in 2006 compared to 2005.

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

In general, the efficiency ratio used by the Company is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation exclude amortization of goodwill and intangibles and non-recurring expenses. Income for the ratio is increased for the favorable effect of tax-exempt income (see Average Balance Sheets and Net Interest Income Analysis), and excludes securities gains and losses,

which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP-based efficiency ratio, which also is presented in this report, which is calculated using non-interest expense and income amounts as shown on the face of the Consolidated Statements of Income. Both types of efficiency ratio calculations are set forth and are reconciled in the table below.

Our (non-GAAP) efficiency ratios for continuing operations for 2006, 2005, and 2004 were 51.1%, 53.8%, and 53.2%, respectively. The following table details the components used in calculation of the efficiency ratios.

GAAP-based and Our Efficiency Ratios

	2006	2005	2004
	(Dollars in thousands)		
GAAP-based efficiency ratio			
Non-interest expenses	$ 49,837	$ 55,591	$ 48,035
Net interest income plus non-interest income	92,968	95,933	86,512
Efficiency ratio GAAP-based	53.61%	57.95%	55.52%
Our efficiency ratio			
Non-interest expenses GAAP-based	$ 49,837	$ 55,591	$ 48,035
Less non-GAAP adjustments:			
Foreclosed property expense	(248)	(288)	(500)
Amortization of intangibles	(410)	(435)	(399)
Prepayment penalties on FHLB advances		(3,794)	
Other non-core, non-recurring expense items	(581)		
Adjusted non-interest expenses	48,598	51,074	47,136
Net interest income plus non-interest income GAAP-based	92,968	95,933	86,512
Plus non-GAAP adjustment:			
Tax-equivalency	4,010	4,072	3,719
Less non-GAAP adjustments:			
Security gains	(75)	(753)	(1,604)
Branch sale gains	(1,035)	(4,366)	
Other non-core, non-recurring income items	(676)		
Adjusted net interest income plus non-interest income	95,192	94,886	88,627
Our efficiency ratio	51.05%	53.83%	53.18%

Equity-based Compensation

On January 1, 2006, the Company adopted the equity-based compensation accounting provisions of Statement of Financial Accounting Standards (SFAS) 123R. Through December 31, 2005, the Company accounted for equity-based compensation under APB Opinion No. 25, using the intrinsic value model. Under Opinion No. 25, the Company recognized no compensation expense related to stock options granted, and provided pro-forma disclosures of the effects of accounting for stock options under the fair value model. The Company selected the modified

prospective method of transition. The adoption of the new equity-based compensation accounting standard resulted in increased compensation expense. The total compensation cost related to stock option awards vesting in 2006 was approximately $208 thousand after-tax.

Income Tax Expense

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are

commonly referred to as permanent differences. The most significant permanent differences for the Company include income on state and municipal securities which are exempt from federal income tax, certain dividend payments which are deductible by the Company, tax credits generated by investments in low income housing and historical building rehabilitation.

Consolidated income taxes for 2006 were $11.5 million, a 28.4% effective tax rate, compared to $10.1 million, an effective tax rate of 27.7%, for 2005. The effective tax rate for 2006 was greater than 2005 due to a lower proportion of tax-free municipal interest income.

As disclosed in previous filings, the state tax audit of state income, franchise, and sales tax in one of the Company s tax jurisdictions was concluded during the fourth quarter of 2005. The outcome of this audit was favorable to the Company and resulted in total state income and franchise tax refunds of approximately $473 thousand, which was reflected in the 2005 provision for income tax expense.

2005 COMPARED TO 2004

Net income for 2005 was $26.3 million, up $3.9 million from $22.4 million in 2004. Basic and diluted earnings per share for 2005 were $2.33 and $2.32, respectively, compared to basic and diluted earnings per share of $1.99 and $1.97, respectively, for 2004. Return on average assets for 2005 and 2004 were 1.37% and 1.24%, respectively. The return on average equity for 2005 and 2004 were 13.79% and 12.53%, respectively. The Company compared favorably to national peer returns of 1.16% and 13.51%, respectively, based on the September 2005 Bank Holding Company Performance Report.

Net Interest Income

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

Net interest income was $73.6 million for 2005, compared to $69.2 million for 2004. Tax-equivalent net interest income totaled $77.7 million for 2005, an increase of $4.8 million from the $72.9 million reported for 2004. The increase reflects a $6.3 million increase due to increased volume, which was partially offset by a $1.5 million decrease due to rate changes on the underlying assets and liabilities.

During 2005, average earning assets increased $118.3 million while average interest-bearing liabilities increased $100.5 million over the comparable period. The yield on average earning assets increased 37 basis points to 6.42% from 6.05% for 2004. The rate earned on assets was positively impacted by the continued increases in short-term market interest rates throughout 2005.

Total cost of average interest-bearing liabilities increased 47 basis points during 2005, as such liabilities were also affected by increases in short-term market interest rates. The net result was a decrease of 10 basis points to net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities. 2005 spread was 4.01% compared to 4.11% for 2004. The Company s tax-equivalent net interest margin of 4.39% for 2005 was essentially unchanged with a small decrease of 2 basis points from 4.41% in 2004.

The largest contributor to the increase in the yield on average earning assets in 2005, on a volume-weighted basis, was the $142.9 million increase in loans held for investment. The loan portfolio contributed approximately $13.1 million to the change in interest income, while the portfolio s average yield increased 28 basis points from the prior year to 6.91%. The yield on variable-rate loans tied to prime and other indices increased in response to the recent increases in short-term interest rates.

During 2005, the tax-equivalent yield on available-for-sale securities increased 36 basis points to 4.98% while the average balance decreased by $17.0 million. Although the total portfolio decreased through the period, the average tax-equivalent yield increased due to the addition of higher-rate securities and the sale of lower-rate

securities. Funds received from the paydowns, maturities, calls, and sales of investment securities helped fund loan growth.

Average interest-bearing balances with banks remained steady during 2005, while the yield increased 154 basis points to 3.36%. The yield on those balances is directly correlated to the increases in the target federal funds rate which occurred throughout the year.

The Company attempts to control the cost of deposited funds in relation to the prevailing economic climate and competitive forces. The Company determines its balance sheet management goals through its Asset/Liability Management Committee. Throughout 2005, the pressures of increasing short-term interest rates resulted in an increase of 40 basis points in the average cost of interest-bearing deposits. The average rate paid on interest-bearing demand deposits remained consistent, while the average rate paid on savings, which includes money market and passbook accounts, increased 32 basis points. The Company was successful in keeping rates paid on interest-bearing checking accounts relatively stable and increased money market account rates to remain competitive. Average time deposits increased $46.2 million while the average rate paid increased 48 basis points to 2.92%. The level of average non-interest-bearing demand deposits increased $16.0 million to $228.8 million compared to the prior year.

Average federal funds purchased and repurchase agreements increased $19.3 million due mostly to increases in the balances of customer repurchase agreements. The average rate paid on those funds also increased, as they are closely tied to the target federal funds rate. Average Federal Home Loan Bank (FHLB) advances increased $29.5 million as the Company borrowed $75 million through the year. Interest paid on those borrowings increased 19 basis points as interest rates were increasing on adjustable-rate borrowings. Other borrowings remained steady, but the rate paid increased 198 points because the majority of such borrowings consist of the Company s trust preferred borrowing, which is tied to LIBOR.

Non-interest Income

Non-interest income consists of all revenues which are not included in interest and fee income related to earning assets. Non-interest income from continuing operations for 2005 was $22.3 million compared to $17.3 million 2004. Wealth management income, which includes fees for trust services and commission and fee income generated by Stone Capital, the Company s prior investment advisory subsidiary, increased $467 thousand in 2005, or 18.8%, compared to 2004 as a result of the Company s continued focus on growth. Stone Capital expanded its retail asset management services through the addition of two investment advisors and the licensing of a number of investment associates within the bank branches.

Service charges on deposit accounts increased $973 thousand, or 10.7%, while other service charges, commissions and fees reflected gains of $546 thousand, or 24.4%. Other service charges, commissions and fees increased largely because of ATM usage fees on foreign cards which totaled $1.4 million and official check commissions which reached $256 thousand.

Other operating income includes $4.4 million in gain from the sale of the Clifton Forge, Virginia, branch location in December 2005. The remaining components of other operating income decreased $525 thousand compared to 2004. During 2005, other operating income included securities gains of $753 thousand, which were $851 thousand less than those recognized in 2004.

Non-interest Expense

Total non-interest expense from continuing operations was $55.6 million, an increase of $7.6 million for 2005 over 2004. The single largest item contributing to the increase was a $3.8 million prepayment penalty incurred in

connection with the early termination of $77.0 million of FHLB advances in late December 2005. Salaries and benefits increased approximately $2.8 million due to increases in staffing to support added corporate services, continued branch and loan production office growth, and increased health benefits costs.

Occupancy and furniture and equipment expenses increased $344 thousand and $447 thousand in 2005, respectively, compared to 2004. The general level of occupancy and furniture and equipment costs in 2005 grew

largely as a result of increases in depreciation and insurance costs associated with de novo branches and depreciation associated with continued investment in operating equipment and technology infrastructure.

All other operating expense accounts increased $100 thousand in 2005 compared to 2004. The most significant item within the increase in other operating expense was the increase in audit fees, which increased over $335 thousand year-over-year.

Income Tax Expense

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are commonly referred to as permanent differences. The most significant permanent differences for the Company include i) income on state and municipal securities which are exempt from federal income tax, ii) certain dividend payments which are deductible by the Company, iii) tax credits generated by investments in low income housing and iv) for 2004, goodwill impairment expense which is not deductible.

Consolidated income taxes for 2005 were $10.1 million, a 27.7% effective tax rate, compared to $7.7 million, an effective tax rate of 25.6%, for 2004. The effective tax rate for 2004 was less than 2005 due to the tax benefits realized from the divestiture of the Company s mortgage banking subsidiary. Specifically, the non-deductible impairment charges recognized in 2003 and the first two quarters of 2004 reduced the book carrying basis of the investment in the mortgage subsidiary and resulted in a permanent difference during the third quarter of 2004 upon sale of the entity. This difference reduced the 2004 effective tax rate to 25.6% and is the primary cause of the increase in the effective tax rate when comparing 2004 to 2005.

FINANCIAL POSITION

Available-for-Sale Securities

Available-for-sale securities were $508.4 million at December 31, 2006, compared to $404.4 million at December 31, 2005, an increase of $104.0 million. The Company purchased securities throughout the year with liquidity provided by net loan portfolio payoffs, and executed two leverage transactions totaling $50 million during 2006.

The Company attempts to maintain an acceptable level of interest rate risk within its securities portfolio. At December 31, 2006, the average life and duration of the portfolio were 7.1 years and 5.4, respectively. Average life and duration remained relatively unchanged from December 31, 2005, at 7.0 years and 5.4, respectively.

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, the expectation for that security s performance, the creditworthiness of the issuer and the Company s intent and ability to hold the security to recovery or maturity. A decline in value that is considered to be other-than-temporary would be recorded as a loss within non-interest income in the Consolidated Statements of Income. The Company does not believe any unrealized loss, individually or in the aggregate, as of December 31, 2006, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes the decline in value is attributable to changes in market interest rates and not the credit quality of the issuer.

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The following table details amortized cost and fair value of available-for-sale securities as of December 31, 2006, 2005, and 2004.

	December 31,					
	2006		2005		2004	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Amounts in thousands)					
U.S. Government agency securities	$ 117,777	$ 116,061	$ 92,739	$ 91,424	$ 46,541	$ 45,946
States and political subdivisions	152,189	154,047	151,118	152,168	142,882	145,146
Corporate Notes	85,080	85,033	61,466	61,274	37,589	38,129
	355,046	355,141	305,323	304,866	227,012	229,221
Mortgage-backed securities	146,444	144,754	94,954	92,994	142,427	142,979
Equities	6,933	8,475	5,390	6,521	2,626	3,797
Total	$ 508,423	$ 508,370	$ 405,667	$ 404,381	$ 372,065	$ 375,997

Held-to-Maturity Securities

Investment securities classified as held-to-maturity are comprised primarily of high-grade state and municipal bonds. These securities generally carry AAA bond ratings, most of which also carry credit enhancement insurance by major insurers of debt instruments. The portfolio totaled $20.0 million at December 31, 2006, compared to $24.2 million at December 31, 2005. This decrease is reflective of continuing paydowns, maturities and calls within the portfolio. The market value of held-to-maturity investment securities was 101.7% and 102.9% of book value at December 31, 2006 and 2005, respectively. Recent trends in interest rates have had little effect on the portfolio market value since December 31, 2005, due to its larger percentage of municipal securities which display less price sensitivity to rate changes.

The average final maturity of the held-to-maturity investment portfolio decreased from 6.6 years at December 31, 2005, to 6.1 years at December 31, 2006, with the tax-equivalent yield increasing from 7.95% at year-end 2005 to 8.02% at the close of 2006. The weighted-average expected maturity of the investment portfolio, based on market assumptions for prepayment, is ten months and 1.6 years at December 2006 and 2005, respectively. The average maturity data differs from final maturity data because of the use of assumptions as to anticipated prepayments, and is generally a more accurate indicator of true average life of the investment.

The following table details amortized cost and fair value of held-to-maturity securities for the three years ended December 31, 2006.

	December 31,					
	2006		2005		2004	
	Amortized	Fair	Amortized	Fair	Amortized	Fair

	Cost	Value	Cost	Value	Cost	Value
			(Amounts in thousands)			
States and political subdivisions	$ 19,638	$ 19,970	$ 23,781	$ 24,486	$ 33,814	$ 35,202
Corporate Notes	375	374	375	374	375	375
	20,013	20,344	24,156	24,860	34,189	35,577
Mortgage-backed securities	6	6	17	17	32	33
Total	$ 20,019	$ 20,350	$ 24,173	$ 24,877	$ 34,221	$ 35,610

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Loans Held for Sale

To mitigate interest rate risk, the Company sells most of the long-term, fixed-rate mortgage loans it originates in the secondary market. At December 31, 2006, the Company held $781 thousand of loans for sale to the secondary market, down from $1.3 million at December 31, 2005. The gross notional amount of outstanding commitments to originate mortgage loans for customers at December 31, 2006, was $6.6 million on 49 loans.

Loans Held for Investment

Total loans held for investment decreased $46.2 million to $1.28 billion at December 31, 2006, from $1.33 billion at December 31, 2005, as a result of decreased loan production and large payoffs occurring throughout 2006. The average loan to deposit ratio increased to 93.3% for 2006, compared with 92.3% for 2005. Average loans held for investment for 2006 of $1.32 billion increased $14.5 million when compared to the average for 2005 of $1.30 billion.

The held for investment loan portfolio continues to be diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition at year-end 2002 through 2006.

Loan Portfolio Summary

	December 31,				
	2006	2005	2004	2003	2002
	(Amounts in thousands)				
Commercial, financial and agricultural	$ 106,645	$ 110,211	$ 99,302	$ 69,395	$ 74,186
Real estate commercial	421,067	464,510	453,899	317,421	285,847
Real estate construction	158,566	143,976	112,705	98,510	72,275
Real estate residential	506,370	504,387	457,417	421,299	364,087
Consumer	88,679	106,206	113,639	119,195	131,385
Other	3,549	1,808	2,012	992	726
Total	1,284,876	1,331,098	1,238,974	1,026,812	928,506
Less unearned income	13	59	218	621	885
	1,284,863	1,331,039	1,238,756	1,026,191	927,621
Less allowance for loan losses	14,549	14,736	16,339	14,624	14,410
Net loans	$ 1,270,314	$ 1,316,303	$ 1,222,417	$ 1,011,567	$ 913,211

The Company maintained no foreign loans in the periods presented. Although the Company s loans are made primarily in the four-state region in which it operates, the Company had no concentrations of loans to one borrower or industry representing 10% or more of outstanding loans at December 31, 2006.

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The following table details the maturities and rate sensitivity of the Company s loan portfolio at December 31, 2006.

	Remaining Maturities				
	One Year and Less	Over One to Five Years	Over Five Years	Total	Percent
	(Amounts in thousands)				
Commercial, financial and agricultural	$ 53,476	$ 49,592	$ 3,577	$ 106,645	8.30%
Real estate commercial	82,588	253,902	84,577	421,067	32.77%
Real estate construction	113,219	40,258	5,089	158,566	12.34%
Real estate mortgage	44,107	161,437	300,826	506,370	39.41%
Consumer	15,986	66,967	5,726	88,679	6.90%
Other	1,251	2,111	187	3,549	0.28%
	$ 310,627	$ 574,267	$ 399,982	$ 1,284,876	100.00%
Rate Sensitivity:					
Pre-determined rate	$ 125,257	$ 456,522	$ 81,833	$ 663,612	51.65%
Floating- or adjustable-rate	185,370	117,745	318,149	621,264	48.35%
	$ 310,627	$ 574,267	$ 399,982	$ 1,284,876	100.00%

Allowance for Loan Losses

The allowance is increased by charges to earnings in the form of provisions and by recoveries of prior charge-offs, and decreased by charge-offs. The provisions are calculated to bring the allowance to a level, which, according to a systematic process of measurement, is reflective of the required amount needed to absorb probable losses.

The allowance for loan losses was $14.5 million at December 31, 2006, compared to $14.7 million at December 31, 2005. Management considers the allowance adequate based upon its analysis of the portfolio as of December 31, 2006, however, no assurance can be made that additions to the allowance for loan losses will not be required in future periods.

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The following table details loan charge-offs and recoveries by loan type for the five years ended December 31, 2002 through 2006.

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(Amounts in thousands)				
Allowance for loan losses at beginning of period	$ 14,736	$ 16,339	$ 14,624	$ 14,410	$ 13,952
Acquisition balances			1,786	1,583	395
Charge-offs:					
Commercial, financial, agricultural and commercial real estate	1,953	5,017	1,925	3,302	2,162
Real estate-residential	1,234	385	723	686	464
Installment	1,356	1,534	1,526	2,133	2,243
Total charge-offs	4,543	6,936	4,174	6,121	4,869
Recoveries:					
Commercial, financial and agricultural	1,032	1,413	727	711	167
Real estate-residential	125	188	90	58	129
Installment	493	418	615	564	428
Total recoveries	1,650	2,019	1,432	1,333	724
Net charge-offs	2,893	4,917	2,742	4,788	4,145
Provision charged to operations	2,706	3,706	2,671	3,419	4,208
Reclassification of allowance for lending-related commitments(1)		(392)			
Allowance for loan losses at end of period	$ 14,549	$ 14,736	$ 16,339	$ 14,624	$ 14,410
Ratio of net charge-offs to average loans outstanding	0.22%	0.38%	0.24%	0.49%	0.45%
Ratio of allowance for loan losses to total loans outstanding	1.13%	1.11%	1.32%	1.43%	1.55%

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

The following table details the allocation of the allowance for loan losses and the percent of loans in each category to total loans for the five years ended December 31, 2006.

December 31,				
2006	2005	2004	2003	2002

(Dollars in thousands)

Commercial, financial and agricultural	$	8,418	53%	$	9,993	58%	$	11,700	57%	$	9,414	47%	$	8,905	47%
Real estate mortgage		3,858	39%		2,462	34%		2,084	34%		2,207	41%		1,684	39%
Consumer		2,273	8%		2,281	8%		2,555	9%		3,003	12%		3,821	14%
Unallocated			0%			0%			0%			0%			0%
Total	$	14,549	100%	$	14,736	100%	$	16,339	100%	$	14,624	100%	$	14,410	100%

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Risk Elements

Non-performing assets include loans on non-accrual status, loans contractually past due 90 days or more and still accruing interest, and other real estate owned. The levels of non-performing assets for the last five years are presented in the following table.

	December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Dollars in thousands)				
Non-accrual loans	$ 3,813	$ 3,383	$ 5,168	$ 2,993	$ 3,075
Loans 90 days or more past due and still accruing interest		11			91
Total non-performing loans	3,813	3,394	5,168	2,993	3,166
Other real estate owned	258	1,400	1,419	2,091	2,855
Total non-performing assets	$ 4,071	$ 4,794	$ 6,587	$ 5,084	$ 6,021
Non-performing loans as a percentage of total loans	0.30%	0.25%	0.42%	0.29%	0.34%
Non-performing assets as a percentage of total loans and other real estate owned	0.32%	0.36%	0.53%	0.49%	0.65%
Allowance for loan losses as a percentage of non-performing loans	381.6%	434.2%	316.2%	488.6%	455.1%
Allowance for loan losses as a percentage of non-performing assets	357.4%	307.4%	248.0%	287.6%	239.3%

Total non-performing assets were $4.1 million at December 31, 2006, compared to $4.8 million at December 31, 2005, a decrease of $723 thousand. Non-accrual loans increased by $430 thousand to $3.8 million at December 31, 2006. Ongoing activity within the classification and categories of non-performing loans continues to include collections on delinquent loans, foreclosures, and movements into or out of the non-performing classification as a result of changing customer business conditions. There were no loans 90 days past due and still accruing at December 31, 2006, and $11 thousand at December 31, 2005. Other real estate owned decreased $1.1 million to $258 thousand in 2006 and is carried at the lesser of estimated net realizable value or cost.

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

During 2006, 2005 and 2004, $1.3 million, $1.3 million, and $2.1 million, respectively, of assets were acquired through foreclosure and transferred to other real estate owned.

The Company has considered all impaired loans in the evaluation of the adequacy of the allowance for loan losses at December 31, 2006. The following table presents additional detail of non-performing and restructured

loans for the five years ended December 31, 2006. Additional information regarding nonperforming loans can be found in Note 5 of the Notes to Consolidated Financial Statements, included in Item 8 hereof.

Non-Performing Loans

	December 31,				
	2006	2005	2004	2003	2002
	(Amounts in thousands)				
Non-accruing loans	$ 3,813	$ 3,383	$ 5,168	$ 2,993	$ 3,075
Loans past due over 90 days and still accruing interest		11			91
Restructured loans performing in accordance with modified terms	272	302	354	356	345
Gross interest income which would have been recorded under original terms of non-accruing and restructured loans	397	380	439	282	222
Actual interest income during the period	286	161	293	194	108

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

At December 31, 2006, there were no significant potential problem loans requiring disclosure beyond those addressed in the preceding tables.

Deposits

Total deposits decreased by $8.5 million, or 0.6%, during 2006. Noninterest-bearing demand deposits increased during 2006 by $14.2 million, or 6.2%, while interest-bearing demand deposits decreased $3.7 million, or 2.6%. Savings deposits, which consist of money market accounts and passbook savings, decreased $37.5 million during 2006, or 10.6%, while time deposits increased $18.6 million, or 2.8%.

Average total deposits remained steady at $1.41 billion for 2006. Average non-interest bearing demand deposits and time deposits increased $8.9 million and $21.9 million during 2006, respectively. Average interest-bearing demand deposits and savings deposits decreased $6.5 and $24.5 million during 2006, respectively. In 2006, the average rate paid on interest bearing deposits was 2.89%, up significantly from 2.03% in 2005. The attrition from interest-bearing demand and savings deposits and the continued increase in time deposits reflects the migration of new and current customer funds in response to the upward movement in time deposit interest rates.

Average Deposits and Average Rates

	2006			2005			2004		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Ra
	(Dollars in thousands)								
st-bearing liabilities:									
nd deposits	$ 146,248	$ 462	0.32%	$ 152,774	$ 401	0.26%	$ 149,502	$ 366	0
gs deposits	343,854	6,857	1.99%	368,339	4,309	1.17%	366,074	3,112	0

deposits	683,418	26,549	3.88%	661,498	19,321	2.92%	615,346	15,001	2
interest-bearing its	$ 1,173,520	$ 33,868	2.89%	$ 1,182,611	$ 24,031	2.03%	$ 1,130,922	$ 18,479	1
nterest bearing nd deposits	$ 237,714			$ 228,781			$ 212,777		

Borrowings

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

Short-term borrowings increased on average approximately $22.3 million compared to the prior year as a result of continued increases in portfolio assets. Funding cost is managed by the Company s Asset/Liability Management Committee, which monitors, among other things, product and pricing, overall cost of funds, and maintenance of an acceptable net interest margin.

Federal funds purchased were $7.7 million and $82.5 million, at December 31, 2006 and 2005, respectively. Repurchase agreements were $201.2 million and $124.2 million at December 31, 2006 and 2005, respectively. Retail repurchase agreements are sold to customers as an alternative to available deposit products. At December 31, 2006, total repurchase agreements included $50 million of wholesale instruments. The Company added $50 million of wholesale repurchase agreement funding during 2006. The weighted-average rate of those repurchase agreements was 4.30% at December 31, 2006. There were no wholesale repurchase agreements at the end of 2005. The underlying securities included in repurchase agreements remain under the Company s control during the effective period of the agreements.

Short-term borrowings include overnight federal funds, and repurchase agreements. Balances and rates paid on short-term borrowings for continuing operations are summarized as follows:

	2006		2005		2004	
	Amount	**Rate**	**Amount**	**Rate**	**Amount**	**Rate**
			(Dollars in thousands)			
At year-end	$ 208,885	3.70%	$ 206,654	2.79%	$ 142,357	1.55%
Average during the year	150,839	3.37%	128,551	2.16%	109,223	1.29%
Maximum month-end balance	208,885		206,654		142,357	

In January 2006, the Company borrowed $75 million in new adjustable-rate advances from the FHLB. $50 million of the advances were hedged by an interest rate swap to approximate a fixed rate of 4.34%. The remaining $25 million floats at an interest rate equal to 3-month LIBOR less 45 basis points.

At December 31, 2006, FHLB borrowings included $175.0 million in convertible and callable advances and $7.2 million of noncallable advances for a total of $182.2 million. The weighted-average interest rates of all advances were 4.64% and 4.17% at December 31, 2006 and 2005, respectively. After considering the effect of the interest rate swap, the weighted-average interest rate of all advances was 4.26% at December 31, 2006. At December 31, 2006, the FHLB advances had maturities between one month and 14 years.

The scheduled maturities of the FHLB advances are as follows:

	(Amounts in thousands)	
2007	$	6,250
2008		

2009		
2010		25,000
2011		
2012 and thereafter		150,957
	$	182,207

Also included in other indebtedness is $15.5 million of junior subordinated debentures issued by the Company in October 2003 through FCBI Capital Trust, an unconsolidated trust subsidiary.

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Liquidity and Capital Resources

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

Total liquidity of $789.4 million at December 31, 2006, is comprised of the following: cash on hand and deposits with other financial institutions of $57.8 million; available-for-sale securities of $508.4 million; held-to-maturity securities due within one year of $125 thousand; and FHLB credit availability of $223.1 million.

Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally used to pay down short-term borrowings. On a longer-term basis, the Company maintains a strategy of investing in securities, mortgage-backed obligations and loans with varying maturities. The Company uses sources of funds primarily to meet ongoing commitments, to pay maturing savings certificates and savings withdrawals, fund loan commitments and maintain a portfolio of securities. At December 31, 2006, approved loan commitments outstanding amounted to $213.4 million. Certificates of deposit scheduled to mature in one year or less totaled $529.9 million. Management believes that the Company has adequate resources to fund outstanding commitments and could either adjust rates on certificates of deposit in order to retain or attract deposits in changing interest rate environments or replace such deposits with advances from the FHLB or other funds providers if it proved to be cost effective to do so.

The following table presents contractual cash obligations as of December 31, 2006.

	December 31, 2006 Total Payments Due by Period				
	Total	**Less Than 1 Year**	**Two to Three Years**	**Four to Five Years**	**After 5 Years**
	(Amounts in thousands)				
Deposits without a stated maturity(1)	$ 703,024	$ 703,024	$	$	$
Federal funds borrowed and overnight security repurchase agreements	103,191	103,191			
Certificates of Deposit(2)(3)	720,284	529,908	127,723	61,841	812
Term security repurchase agreements	129,022	57,942	5,262	4,918	60,900
FHLB advances(2)(3)	262,869	14,107	15,662	39,253	193,847
Trust preferred indebtedness	50,203	1,287	2,573	2,573	43,770
Leases	2,779	700	1,044	462	573
Total	$ 1,971,372	$ 1,410,159	$ 152,264	$ 109,047	$ 299,902

(1) Excludes interest.

(2) Includes interest on both fixed and variable-rate obligations. The interest associated with variable-rate obligations is based upon interest rates in effect at December 31, 2006. The interest to be paid on variable-rate

obligations is affected by changes in market interest rates, which materially affect the contractual obligation amounts to be paid.

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

The following table presents detailed information regarding the Company s off-balance sheet arrangements at December 31, 2006.

	December 31, 2006 Amount of Commitment Expiration Per Period									
		Total		Less than One Year		Two to Three Years		Four to Five Years		After Five Years
	(Amounts in thousands)									
Commitments to extend credit										
Commercial, financial and agricultural	$	34,842	$	32,475	$	664	$	74	$	1,629
Real estate commercial		24,609		18,718		2,690		2,411		790
Real estate residential		61,742		15,953		1,817		2,934		41,038
Real estate construction		68,899		60,085		2,292		3,159		3,363
Consumer lines of credit		23,303		23,017		265		21		
Total unused commitments	$	213,395	$	150,248	$	7,728	$	8,599	$	46,820
Financial letters of credit	$	1,593	$	1,539	$	37	$	7	$	10
Performance letters of credit		5,389		3,200		1,992		133		64
Total letters of credit	$	6,982	$	4,739	$	2,029	$	140	$	74

In January 2006, the Company entered into a pay fixed and receive variable interest rate swap. The swap effectively fixes $50 million of FHLB borrowings at 4.34% for a period of five years. Management does not anticipate this derivative transaction will have a significant impact on reported earnings or cash flows.

Stockholders Equity

Total stockholders equity increased $18.2 million to $212.7 million at December 31, 2006, as the Company continued to balance capital adequacy and returns to stockholders. The increase in equity was due mainly to net earnings of $28.9 million less dividends paid to stockholders of $11.7 million.

Risk-based capital guidelines and the leverage ratio measure capital adequacy of banking institutions. At December 31, 2006, the Company s Tier I capital ratio was 11.60% compared with 10.54% in 2005. The Company s total risk-based capital-to-asset ratio was 12.69% at the close of 2006 compared with 11.65% in 2005. Both of these ratios are well above the current minimum level of 8% prescribed for bank holding companies. The leverage ratio is the measurement of total tangible equity to total assets. The Company s leverage ratio at December 31, 2006, was 8.50% versus 7.77% at December 31, 2005, both of which are well above the minimum levels prescribed by the Federal Reserve. See Note 14 of the Notes to Consolidated Financial Statements in Item 8 hereof.

Trust and Investment Management Services

As part of its community banking services, the Company offers trust management and estate administration services through its Trust and Financial Services Division (Trust Division). The Trust Division reported market value of assets

under management of $507 million and $487 million at December 31, 2006 and 2005, respectively. The Trust Division manages inter vivos trusts and trusts under will, develops and administers employee benefit plans and individual retirement plans and manages and settles estates. Fiduciary fees for these services are charged on a schedule related to the size, nature and complexity of the account.

The Trust Division employs 16 professionals and full time equivalent support staff with a wide variety of estate and financial planning, investing and plan administration skills. The Trust Division is located within the Company s banking offices in Bluefield, West Virginia. Services and trust development activities are offered to other branch locations and primary markets through the Bluefield-based division.

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

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

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

In order to mitigate the effect of changes in the general level of interest rates, the Company manages repricing opportunities and thus, its interest rate sensitivity. The Company seeks to control its interest rate risk (IRR) exposure to insulate net interest income and net earnings from fluctuations in the general level of interest rates. To measure its exposure to IRR, quarterly simulations of net interest income are performed using financial models that project net interest income through a range of possible interest rate environments including rising, declining, most likely and flat rate scenarios. The results of these simulations indicate the existence and severity of IRR in each of those rate environments based upon the current balance sheet position, assumptions as to changes in the volume and mix of interest-earning assets and interest-paying liabilities, management s estimate of yields to be attained in those future rate environments, and rates that will be paid on various deposit instruments and borrowings. Specific strategies for management of IRR have included shortening the amortized maturity of new fixed-rate loans, increasing the volume of adjustable-rate loans to reduce the repricing term of the Bank s interest-earning assets, and monitoring the term structure of liabilities to maintain a balanced mix of maturity and repricing to mitigate the potential exposure. The simulation model used by the Company captures all earning assets, interest-bearing liabilities and all off-balance sheet financial instruments and combines the various factors affecting rate sensitivity into an earnings outlook. Based upon the latest simulation, the Company believes that it is biased slightly toward a liability sensitive position. Absent adequate management, liability sensitive positions can negatively impact net interest income in a rising rate environment or, alternatively, positively impact net interest income in a falling rate environment.

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

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The following table summarizes the impact of immediate and sustained rate shocks in the interest rate environment on net interest income and the economic value of equity as of December 31, 2006 and 2005. The model simulates plus and minus 200 basis points from the base case rate simulation at December 31, 2006. This table, which illustrates the prospective effects of hypothetical interest rate changes, is based upon numerous assumptions including relative and estimated levels of key interest rates over a twelve-month time period. This modeling technique, although useful, does not take into account all strategies that management might undertake in response to a sudden and sustained rate shock as depicted. Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other internal and external variables.

Rate Sensitivity Analysis

	2006			
Increase (Decrease) in Interest Rates (Basis Points)	**Change in Net Interest Income**	**% Change**	**Change in Market Value of Equity**	**% Change**
		(Dollars in thousands)		
200	$ (2,006)	(2.8)	$ (16,229)	(5.4)
100	(958)	(1.3)	(7,453)	(2.5)
(100)	(1,024)	(1.4)	(4,301)	(1.4)
(200)	(1,614)	(2.3)	(18,278)	(6.1)

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

ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.*

Consolidated Financial Statements

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FIRST COMMUNITY BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2006	December 31, 2005
	(Amounts in thousands, except share and per share data)	
ASSETS		
Cash and due from banks	$ 47,909	$ 46,872
Interest-bearing balances with banks	9,850	10,667
Total cash and cash equivalents	57,759	57,539
Securities available for sale (amortized cost of $508,423, 2006; $405,667, 2005)	508,370	404,381
Securities held to maturity (fair value of $20,350, 2006; $24,877, 2005)	20,019	24,173
Loans held for sale	781	1,274
Loans held for investment, net of unearned income	1,284,863	1,331,039
Less allowance for loan losses	14,549	14,736
Net loans held for investment	1,270,314	1,316,303
Premises and equipment, net	36,889	34,993
Other real estate owned	258	1,400
Interest receivable	12,141	10,232
Goodwill	60,135	59,182
Other intangible assets	2,061	1,937
Other assets	64,971	41,069
Total Assets	$ 2,033,698	$ 1,952,483
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 244,771	$ 230,542
Interest-bearing	1,150,000	1,172,678
Total Deposits	1,394,771	1,403,220
Interest, taxes and other liabilities	19,641	18,877
Federal funds purchased	7,700	82,500
Securities sold under agreements to repurchase	201,185	124,154
FHLB borrowings and other indebtedness	197,671	129,231
Total Liabilities	1,820,968	1,757,982
Stockholders Equity		

Preferred stock, par value undesignated; 1,000,000 shares authorized; no shares issued and outstanding in 2006 and 2005		
Common stock, $1 par value; shares authorized: 25,000,000; shares issued: 11,499,018 in 2006 and 11,496,312 in 2005; shares outstanding: 11,245,742 in 2006 and 11,251,803 in 2005	11,499	11,496
Additional paid-in capital	108,806	108,573
Retained earnings	100,117	82,828
Treasury stock, at cost	(7,924)	(7,625)
Accumulated other comprehensive income	232	(771)
Total Stockholders Equity	212,730	194,501
Total Liabilities and Stockholders Equity	$ 2,033,698	$ 1,952,483

See Notes to Consolidated Financial Statements.

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FIRST COMMUNITY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2006	2005	2004
	(Amounts in thousands, except share and per share data)		
Interest Income:			
Interest and fees on loans	$ 97,460	$ 89,903	$ 76,713
Interest on securities-taxable	13,951	11,077	12,119
Interest on securities-nontaxable	7,371	7,451	6,712
Interest on federal funds sold and deposits in banks	1,244	1,077	592
Total interest income	120,026	109,508	96,136
Interest Expense:			
Interest on deposits	33,868	24,030	18,478
Interest on short-term borrowings	6,977	9,721	7,585
Interest on long-term debt	7,536	2,129	890
Total interest expense	48,381	35,880	26,953
Net interest income	71,645	73,628	69,183
Provision for loan losses	2,706	3,706	2,671
Net interest income after provision for loan losses	68,939	69,922	66,512
Noninterest Income:			
Wealth management income	2,811	2,956	2,489
Service charges on deposit accounts	10,242	10,095	9,122
Other service charges, commissions and fees	2,992	2,785	2,239
Net gains on sale of securities	75	753	1,604
Other operating income	5,203	5,716	1,875
Total noninterest income	21,323	22,305	17,329
Noninterest Expense:			
Salaries and employee benefits	26,867	29,481	26,646
Occupancy expense of bank premises	4,068	3,903	3,559
Furniture and equipment expense			