OLD POINT FINANCIAL CORP
Form 10-Q
August 07, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 000-12896

OLD POINT FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

VIRGINIA	**54-1265373**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1 West Mellen Street, Hampton, Virginia 23663

(Address of principal executive offices) (Zip Code)

(757) 728-1200

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes ¨ No

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

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

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

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

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

4,909,035 shares of common stock ($5.00 par value) outstanding as of July 31, 2009

Table of Contents

OLD POINT FINANCIAL CORPORATION

FORM 10-Q

INDEX

		Page
	PART I - FINANCIAL INFORMATION	
Item 1.	**Financial Statements.**	**1**
	Consolidated Balance Sheets June 30, 2009 (unaudited) and December 31, 2008	**1**
	Consolidated Statements of Income Three months ended June 30, 2009 and 2008 (unaudited)	**2**
	Six months ended June 30, 2009 and 2008 (unaudited)	**2**
	Consolidated Statements of Changes in Stockholders Equity Six months ended June 30, 2009 and 2008 (unaudited)	**3**
	Consolidated Statements of Cash Flows Six months ended June 30, 2009 and 2008 (unaudited)	**4**
	Notes to Consolidated Financial Statements (unaudited)	**5**
Item 2.	**Management s Discussion and Analysis of Financial Condition and Results of Operations.**	**14**
Item 3.	**Quantitative and Qualitative Disclosures About Market Risk.**	**24**
Item 4.	**Controls and Procedures.**	**25**
	PART II - OTHER INFORMATION	
Item 1.	**Legal Proceedings.**	**25**
Item 1A.	**Risk Factors.**	**25**
Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds.**	**26**
Item 3.	**Defaults Upon Senior Securities.**	**26**
Item 4.	**Submission of Matters to a Vote of Security Holders.**	**26**
Item 5.	**Other Information.**	**26**
Item 6.	**Exhibits.**	**26**

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Old Point Financial Corporation and Subsidiaries

Consolidated Balance Sheets

	June 30, 2009 (unaudited)	December 31, 2008
Assets		
Cash and due from banks	$ 23,185,577	$ 29,511,080
Federal funds sold	1,821,940	17,813,633
Cash and cash equivalents	25,007,517	47,324,713
Securities available-for-sale, at fair value	136,665,687	96,987,569
Securities held-to-maturity (fair value approximates $1,994,731 and $3,115,960)	1,967,000	3,067,000
Restricted securities	4,814,700	4,791,050
Loans, net of allowance for loan losses of $7,274,955 and $6,405,574	625,145,596	631,046,420
Premises and equipment, net	28,892,242	27,143,353
Bank owned life insurance	14,370,275	14,017,638
Other real estate owned, net	8,031,524	3,751,000
Other assets	8,169,460	6,836,111
	$ 853,064,001	$ 834,964,854
Liabilities & Stockholders Equity		
Deposits:		
Noninterest-bearing deposits	$ 109,544,170	$ 123,754,554
Savings deposits	185,750,321	187,105,048
Time deposits	331,314,143	335,664,077
Total deposits	626,608,634	646,523,679
Federal funds purchased, repurchase agreements and other borrowings	77,628,222	33,282,214
Federal Home Loan Bank advances	65,000,000	70,000,000
Accrued expenses and other liabilities	2,126,772	2,261,051
Total liabilities	771,363,628	752,066,944
Commitments and contingencies		
Stockholders equity:		
Common stock, $5 par value, 10,000,000 shares authorized; 4,909,035 and 4,905,229 shares issued	24,545,175	24,526,145
Additional paid-in capital	15,638,412	15,506,322
Retained earnings	42,004,791	43,250,906
Accumulated other comprehensive loss	(488,005)	(385,463)
Total stockholders equity	81,700,373	82,897,910
	$ 853,064,001	$ 834,964,854

See Notes to Consolidated Financial Statements.

Table of Contents

Old Point Financial Corporation and Subsidiaries

Consolidated Statements of Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(unaudited)		(unaudited)	
Interest and Dividend Income:				
Interest and fees on loans	$ 9,400,770	$ 10,093,806	$ 18,817,376	$ 20,346,432
Interest on federal funds sold	8,770	112,641	22,027	329,835
Interest on securities:				
Taxable	710,202	864,736	1,369,784	1,857,610
Tax-exempt	154,319	244,696	313,633	520,196
Dividends and interest on all other securities	119,959	339,670	266,842	475,571
Total interest and dividend income	10,394,020	11,655,549	20,789,662	23,529,644
Interest Expense:				
Interest on savings deposits	98,375	262,781	193,066	673,344
Interest on time deposits	2,607,016	3,348,926	5,435,088	6,961,762
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	144,056	213,394	241,419	549,501
Interest on Federal Home Loan Bank advances	853,454	1,024,668	1,748,829	2,049,336
Total interest expense	3,702,901	4,849,769	7,618,402	10,233,943
Net interest income	6,691,119	6,805,780	13,171,260	13,295,701
Provision for loan losses	3,000,000	300,000	4,000,000	600,000
Net interest income, after provision for loan losses	3,691,119	6,505,780	9,171,260	12,695,701
Noninterest Income:				
Income from fiduciary activities	763,482	807,075	1,528,220	1,655,000
Service charges on deposit accounts	1,375,733	1,464,306	2,712,672	2,891,859
Other service charges, commissions and fees	655,888	669,026	1,268,262	1,379,457
Income from bank owned life insurance	176,014	179,574	352,029	357,154
Other operating income	129,350	53,829	204,010	113,764
Total noninterest income	3,100,467	3,173,810	6,065,193	6,397,234
Noninterest Expense:				
Salaries and employee benefits	4,348,441	4,252,361	8,814,453	8,289,221
Occupancy and equipment	1,011,600	931,639	2,046,503	1,873,074
FDIC insurance	750,897	16,760	853,062	33,939
Data processing	274,045	252,040	523,295	488,776
Customer development	183,813	187,744	382,160	410,395
Advertising	180,086	225,381	351,580	409,740
Loan expenses	166,802	40,849	300,974	98,810
Employee professional development	130,107	178,758	271,820	330,863
Postage and courier	131,376	134,452	268,579	270,928
Loss on write-down/sale of other real estate owned	73,893		141,209	
Other	639,785	736,697	1,341,297	1,412,407
Total noninterest expense	7,890,845	6,956,681	15,294,932	13,618,153

Income (loss) before income taxes	(1,099,259)	2,722,909	(58,479)	5,474,782
Income tax expense (benefit)	(477,341)	787,763	(206,265)	1,569,650
Net income (loss)	$ (621,918)	$ 1,935,146	$ 147,786	$ 3,905,132
Basic Earnings per Share:				
Average shares outstanding	4,908,216	4,903,532	4,907,616	4,905,549
Net income (loss) per share of common stock	$ (0.13)	$ 0.40	$ 0.03	$ 0.80
Diluted Earnings per Share:				
Average shares outstanding	4,940,606	4,934,292	4,937,085	4,937,017
Net income (loss) per share of common stock	$ (0.13)	$ 0.39	$ 0.03	$ 0.79

See Notes to Consolidated Financial Statements.

Table of Contents

Old Point Financial Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity

(unaudited)	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
FOR SIX MONTHS ENDED JUNE 30, 2009						
Balance at beginning of period	4,905,229	$ 24,526,145	$ 15,506,322	$ 43,250,906	$ (385,463)	$ 82,897,910
Comprehensive income:						
Net income				147,786		147,786
Unrealized holding losses arising during the period (net of tax benefit, $52,825)					(102,542)	(102,542)
Total comprehensive income				147,786	(102,542)	45,244
Exercise of stock options	5,624	28,120	77,308	(41,541)		63,887
Retirement of common stock	(1,818)	(9,090)		(27,189)		(36,279)
Stock compensation expense			54,782			54,782
Cash dividends ($.27 per share)				(1,325,171)		(1,325,171)
Balance at end of period	4,909,035	$ 24,545,175	$ 15,638,412	$ 42,004,791	$ (488,005)	$ 81,700,373
FOR SIX MONTHS ENDED JUNE 30, 2008						
Balance at beginning of period	4,907,567	$ 24,537,835	$ 15,357,005	$ 40,039,194	$ (226,836)	$ 79,707,198
Comprehensive income:						
Net income				3,905,132		3,905,132
Unrealized holding losses arising during the period (net of tax benefit, $33,103)					(64,259)	(64,259)
Total comprehensive income				3,905,132	(64,259)	3,840,873
Adjustment to apply FASB Statement No. 158 (net of tax benefit, $0,000) (in regards to pension plan)					22,299	22,299
Adjustment to apply EITF 06-4 (in regards to split-dollar life insurance)				(425,051)		(425,051)
Repurchase and retirement of common stock	(5,400)	(27,000)		(70,207)		(97,207)
Stock compensation expense			57,154			57,154
Cash dividends ($.32 per share)				(1,569,558)		(1,569,558)
Balance at end of period	4,902,167	$ 24,510,835	$ 15,414,159	$ 41,879,510	$ (268,796)	$ 81,535,708

See Notes to Consolidated Financial Statements.

Table of Contents

Old Point Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 147,786	$ 3,905,132
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	914,978	875,701
Provision for loan losses	4,000,000	600,000
Net accretion and amortization of securities	(11,792)	(28,546)
Net loss on disposal of premises and equipment	152	2,172
Net loss on write-down/sale of other real estate owned	141,209	
Income from bank owned life insurance	(352,029)	(357,762)
Stock compensation expense	54,782	57,154
Deferred tax benefit	(297,243)	(152,704)
Increase in other assets	(8,378,041)	(2,212,423)
Increase (decrease) in other liabilities	(134,279)	683,544
Net cash provided by (used in) operating activities	(3,914,477)	3,372,268
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(98,911,221)	(24,736,953)
Purchases of held-to-maturity securities	(600,000)	(1,700,000)
Purchases of restricted securities	(23,650)	(43,200)
Proceeds from maturities and calls of securities	58,494,528	53,702,444
Proceeds from sales of available-for-sale securities	2,295,000	3,845,000
(Increase) decrease in loans made to customers	1,900,825	(29,783,242)
Proceeds from sales of other real estate owned	2,972,418	
Purchases of premises and equipment	(2,664,019)	(1,470,427)
Net cash used in investing activities	(36,536,119)	(186,378)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in noninterest-bearing deposits	(14,210,384)	11,562,312
Decrease in savings deposits	(1,354,727)	(2,146,976)
Increase (decrease) in time deposits	(4,349,934)	9,097,008
Increase (decrease) in federal funds purchased, repurchase agreements and other borrowings	44,346,008	(7,361,423)
Decrease in Federal Home Loan Bank advances	(5,000,000)	
Proceeds from exercise of stock options	27,608	
Repurchase and retirement of common stock		(97,207)
Cash dividends paid on common stock	(1,325,171)	(1,569,558)
Net cash provided by financing activities	18,133,400	9,484,156
Net increase (decrease) in cash and cash equivalents	(22,317,196)	12,670,046
Cash and cash equivalents at beginning of period	47,324,713	51,564,196
Cash and cash equivalents at end of period	$ 25,007,517	$ 64,234,242

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	$ 7,732,570	$ 10,620,045
Income tax	$ 650,000	$ 1,450,000
SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS		
Unrealized (loss) on investment securities	$ (155,367)	$ (97,362)
Loans transferred to other real estate owned	$ 8,485,524	$ 1,125,911
Adjustment to apply EITF 06-4 (in regards to split-dollar life insurance)	$	$ (425,051)

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (the Company) and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at June 30, 2009 and December 31, 2008, the results of operations for the three months and six months ended June 30, 2009 and 2008, and the statements of cash flows and changes in stockholders equity for the six months ended June 30, 2009 and 2008. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2008 annual report on Form 10-K. Certain previously reported amounts have been reclassified to conform to current period presentation.

Available Information

The Company maintains a website on the Internet at www.oldpoint.com. The Company makes available free of charge, on or through its website, its proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). The information available at the Company s Internet address is not part of this Form 10-Q or any other report filed by the Company with the SEC. The public may read and copy any documents the Company files at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company s SEC filings can also be obtained on the SEC s website on the Internet at www.sec.gov.

Note 2. Securities

Amortized costs and fair values of securities held-to-maturity at June 30, 2009 and December 31, 2008 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
June 30, 2009				
Obligations of U.S. Government agencies	$ 1,500	$ 7	$ (3)	$ 1,504
Obligations of state and political subdivisions	467	24		491
Total	$ 1,967	$ 31	$ (3)	$ 1,995
December 31, 2008				
Obligations of U.S. Government agencies	$ 2,600	$ 28	$	$ 2,628
Obligations of state and political subdivisions	467	21		488
Total	$ 3,067	$ 49	$	$ 3,116

Table of Contents

Amortized costs and fair values of securities available-for-sale at June 30, 2009 and December 31, 2008 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
June 30, 2009				
U.S. Treasury securities	$ 400	$	$	$ 400
Obligations of U.S. Government agencies	120,439	696	(14)	121,121
Obligations of state and political subdivisions	11,426	134		11,560
Mortgage-backed securities	1,894	48		1,942
Money market investments	1,643			1,643
Total	$ 135,802	$ 878	$ (14)	$ 136,666
December 31, 2008				
U.S. Treasury securities	$ 399	$ 1	$	$ 400
Obligations of U.S. Government agencies	77,241	871		78,112
Obligations of state and political subdivisions	14,959	156		15,115
Mortgage-backed securities	2,462		(9)	2,453
Money market investments	908			908
Total	$ 95,969	$ 1,028	$ (9)	$ 96,988

Table of Contents

Information pertaining to securities with gross unrealized losses at June 30, 2009 and December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	June 30, 2009					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
	(in thousands)					
Securities Available-for-Sale						
Debt securities:						
Obligations of U.S. Government agencies	$ 14	$ 5,183	$	$	$ 14	$ 5,183
Total securities available-for-sale	$ 14	$ 5,183	$	$	$ 14	$ 5,183
Securities Held-to-Maturity						
Obligations of U.S. Government agencies	$ 3	$ 297	$	$	$ 3	$ 297
Total securities held-to-maturity	$ 3	$ 297	$	$	$ 3	$ 297
Total	$ 17	$ 5,480	$	$	$ 17	$ 5,480

	December 31, 2008					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
	(in thousands)					
Securities Available-for-Sale						
Debt securities:						
Mortgage-backed securities	$ 9	$ 2,453	$	$	$ 9	$ 2,453
Total securities available-for-sale	$ 9	$ 2,453	$	$	$ 9	$ 2,453

The Company has the ability and intent to hold these securities until maturity. None of the securities are impaired due to credit issues. Therefore, securities with losses are considered temporarily impaired.

The restricted security category on the balance sheets is comprised of Federal Home Loan Bank of Atlanta (FHLB) and Federal Reserve Bank (FRB) stock. These stocks are classified as restricted securities because their ownership is restricted and they lack a market. Therefore, this stock is carried at cost and evaluated for impairment. Restricted stock is viewed as a long-term investment. When evaluating this stock for impairment, its value is determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The FHLB has not paid a dividend since the third quarter of 2008 and had a net loss in the quarter ended March 31, 2009. Therefore, the Company evaluated the positive and negative factors of the FHLB stock for impairment. Information from the FHLB s annual report on Form 10-K for the fiscal year ended December 31, 2008, its quarterly report on Form 10-Q for the quarter ended March 31, 2009, its earnings announcements and letters from the President and Chief Executive Officer of the FHLB were used as part of the Company s impairment analysis. The following are the results of the impairment analysis:

During the first quarter of 2009, the FHLB experienced a 9.17% decrease in total assets from December 31, 2008. This decrease was primarily due to a decrease in advances during the quarter. The total capital of the FHLB decreased $2.9 billion or 32.4% during the first quarter of 2009. This decrease was due primarily to a decrease in the bank s capital stock due to the reclassification of $1.8 billion in capital stock held by Countrywide Bank, FSB and total other-than-temporary impairment

Table of Contents

losses on the FHLB s private-label mortgage-backed securities. The first quarter of 2009 is the first quarter this decline in net assets and capital stock has occurred. On February 27, 2009, the FHLB announced changes in its Subclass B1 membership stock requirements and changes in the process for evaluating and approving excess activity-based stock repurchases. The FHLB notes that it believes these changes will facilitate capital management. The Company will monitor the FHLB s financial statements for changes in net assets as compared to capital stock changes.

In a letter from the President and Chief Executive Officer of the FHLB dated June 3, 2009, the President said, Given the extremely challenging market conditions, we believe that the Bank performed well for the quarter on an operating basis, and it earned net interest income of $35.7 million. However, as a result of charges associated with the other-than-temporary impairment (OTTI) of certain of our mortgage-backed securities, the Bank reported a net loss for the quarter.

As of March 31, 2009, the FHLB was in compliance with all of its regulatory capital requirements. Total regulatory capital to assets ratio was 4.59%, exceeding the 4.00% requirement and risk-based capital was $8.7 billion, exceeding the $5.9 billion requirement.

Due to the fact that restricted stock is considered a long-term investment, the Company has the ability and the intent to hold this stock. As a result of the above analysis, the Company determined the FHLB stock was not impaired as of June 30, 2009.

Note 3. Loans

Loans at June 30, 2009 and December 31, 2008 are summarized as follows:

	June 30, 2009	December 31, 2008
	(in thousands)	
Commercial	$ 74,510	$ 73,091
Real estate-construction	$ 48,669	$ 60,604
Real estate-mortgage	$ 469,384	$ 459,921
Installment loans to individuals	36,834	40,789
Other	2,630	2,733
Total loans	632,027	637,138
Less: Allowance for loan losses	(7,275)	(6,406)
Net deferred loan costs *	394	314
Loans, net	$ 625,146	$ 631,046

* Net deferred loans costs are part of real estate - mortgage

The following is a summary of information pertaining to impaired loans, nonaccrual loans and loans ninety days or more past due and still accruing interest:

	June 30, 2009	December 31, 2008
	(in thousands)	

Impaired loans without a valuation allowance	$	$ 12,023
Impaired loans with a valuation allowance	5,314	888
Total impaired loans	$ 5,314	$ 12,911
Valuation allowance related to impaired loans	$ 1,335	$ 269
Total nonaccrual loans	$ 5,925	$ 1,045
Total loans past-due ninety days or more and still accruing interest	$ 1,217	$ 3,529

Table of Contents

Note 4. Allowance for Loan Losses

The following summarizes activity in the allowance for loan losses for the six months ended June 30, 2009 and the year ended December 31, 2008:

	June 30, 2009	December 31, 2008
	(in thousands)	
Balance, beginning of year	$ 6,406	$ 5,130
Recoveries	134	463
Provision for loan losses	4,000	2,400
Loans charged off	(3,265)	(1,587)
Balance, end of period	$ 7,275	$ 6,406

Note 5. Share-Based Compensation

Share-based compensation arrangements include stock options, restricted stock awards, performance-based awards, stock appreciation rights and employee stock purchase plans. Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS 123(R)) requires all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period. SFAS 123(R) was adopted by the Company as of January 1, 2006.

Since its adoption of SFAS 123(R), the Company issued options once in October 2007. The fair value of the options granted in 2007 was estimated using the Black-Scholes option pricing model with the following assumptions: dividend yield of 2.46%, expected volatility of 27.398%, risk-free interest rate of 4.47% and an expected option life of six and one-half years. The grant-date fair value of options granted during 2007 was $5.48 per share.

On March 9, 2008, the Company s 1998 stock option plan expired. Options to purchase 278,775 shares of common stock were outstanding at June 30, 2009. The exercise price of each option equals the market price of the Company s common stock on the date of the grant and each option s maximum term is ten years.

Stock option plan activity for the six months ended June 30, 2009 is summarized below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding, January 1	286,899	$ 18.25		
Granted				
Exercised	(5,624)	11.36		
Canceled or expired	(2,500)	21.94		
Options outstanding, June 30	278,775	$ 18.35	5.23	$ 625
Options exercisable, June 30	192,807	$ 17.60	3.86	$ 625

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on June 30, 2009. This amount changes based on changes in the market value of the Company s stock.

Table of Contents

As of June 30, 2009, there was $367 thousand unrecognized compensation which relates to unvested options.

SFAS 123(R) requires the benefits of tax deductions from the exercise of stock options in excess of grant-date fair value to be reported as a financing cash flow. The Company did not have any tax benefit deductions from the exercise of stock options for the first half of 2009.

Note 6. Pension Plan

The Company provides pension benefits for eligible participants through a non-contributory defined benefits pension plan. The plan was frozen effective September 30, 2006; therefore, no additional participants will be added to the plan. The components of net periodic pension cost (benefit) are as follows:

Quarter ended June 30,	**2009**	**2008**
	Pension Benefits	
Interest cost	$ 71,058	$ 76,095
Expected return on plan assets	(82,666)	(109,882)
Amortization of net loss	25,861	
Net periodic pension plan cost (benefit)	$ 14,253	$ (33,787)

Six months ended June 30,	**2009**	**2008**
	Pension Benefits	
Interest cost	142,116	152,190
Expected return on plan assets	(165,333)	(219,765)
Amortization of net loss	51,722	
Net periodic pension plan cost (benefit)	$ 28,505	$ (67,575)

The Company has not made any contributions to the plan during 2009.

Note 7. Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares attributable to outstanding stock options.

The Company did not include 186 thousand potential common shares attributable to outstanding stock options in the diluted earnings per share calculation because they were antidilutive.

Note 8. Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued its FASB Staff Position (FSP) on Financial Accounting Standard (FAS) 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (FSP FAS 141(R)-1). FSP FAS 141(R)-1 amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company does not expect the adoption of FSP FAS 141(R)-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. FSP FAS 157-4 provides additional guidance for estimating

fair value in accordance with SFAS No. 157, Fair Value Measurements (SFAS 157) when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that

indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. The Company adopted FSP FAS 157-4 effective for the quarter ended June 30, 2009, and the adoption did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board (APB) 28-1, Interim Disclosures about Fair Value of Financial Instruments (APB 28-1). FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009. The Company adopted FSP FAS 107-1 and APB 28-1 effective for the quarter ended June 30, 2009, and the adoption did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. FSP FAS 115-2 and FAS 124-2 amends other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009. The Company adopted of FSP FAS 115-2 and FAS 124-2 effective for the quarter ended June 30, 2009, and the adoption did not have a material impact on the Company s consolidated financial statements.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 (SAB 111). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities. SAB 111 maintains the SEC Staff s previous views related to equity securities and amends Topic 5.M. to exclude debt securities from its scope. The Company does not expect the implementation of SAB 111 to have a material impact on its consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. The Company adopted SFAS 165 effective for the quarter ended June 30, 2009, and the adoption did not have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166 Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 (SFAS 166). SFAS 166 provides guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. SFAS 166 must be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Company does not expect the adoption of SFAS 166 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167). SFAS 167 improves financial reporting by enterprises involved with variable interest entities. SFAS 167 will be effective as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Company does not expect the adoption of SFAS 167 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162.

Table of Contents

(SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification, which will become the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, SFAS 168 will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in SFAS 168 will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect the adoption of SFAS 168 to have a material impact on its consolidated financial statements.

In June 2009, the SEC issued SAB No. 112 (SAB 112). SAB 112 revises or rescinds portions of the interpretative guidance included in the codification of SABs in order to make the interpretive guidance consistent with current GAAP. The Company does not expect the adoption of SAB 112 to have a material impact on its consolidated financial statements.

Note 9. Fair Value Measurements

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS No. 107 Disclosures about Fair Value of Financial Instruments (SFAS 107) excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company s financial instruments.

The estimated fair values, and related carrying or notional amounts, of the Company s financial instruments are as follows:

	June 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Financial assets:				
Cash and cash equivalents	$ 25,008	$ 25,008	$ 47,325	$ 47,325
Securities available-for-sale	136,666	136,666	96,988	96,988
Securities held-to-maturity	1,967	1,995	3,067	3,116
Loans, net of allowances for loan losses	625,146	627,146	631,046	633,820
Accrued interest receivable	3,059	3,059	3,210	3,210
Financial liabilities:				
Deposits	626,609	629,425	646,524	649,055
Federal funds purchased, repurchase agreements and other borrowings	77,628	77,634	33,282	33,282
Federal Home Loan Bank advances	65,000	70,178	70,000	77,219
Accrued interest payable	1,661	1,661	1,777	1,777

SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s market assumptions. The three levels of the fair value hierarchy under SFAS 157 based on these two types of inputs are as follows:

Level 1 Valuation is based on quoted prices in active markets for identical assets and liabilities.

Table of Contents

Level 2 Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available-for-sale

Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company s securities are considered to be Level 2 securities.

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2009:

		Fair Value Measurements at June 30, 2009 (in thousands)		
Description	**Balance**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets:				
Available-for-sale securities	$ 136,666	$	$ 136,666	$

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable

collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as part of the provision for loan losses on the Consolidated Statements of Income.

Other real estate owned

Loans are transferred to other real estate owned when the collateral securing them is foreclosed on. The measurement of loss associated with other real estate owned is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property. If there is a contract for the sale of a property, and management reasonably believes the contract will be executed, fair value is based on the sale price in that contract (Level 1). Lacking such a contract, the value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. Any fair value adjustments to other real estate owned are recorded in the period incurred and expensed against current earnings.

The following table summarizes the Company s financial assets that were measured at fair value on a nonrecurring basis as of June 30, 2009:

		Carrying Value at June 30, 2009 (in thousands)		
Description	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired Loans	$ 3,979	$	$ 3,102	$ 877
Other Real Estate Owned	$ 8,032	$	$ 7,262	$ 770

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

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company. The Company consists of the parent company and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services, N. A. (Trust), collectively referred to as the Company. This discussion should be read in conjunction with the consolidated financial statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements

In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy and financial and other goals. Forward-looking statements often use words such as believes, expects, plans, may, will, should, projects, contemplates, ant forecasts, intends or other words of similar meaning. Forward-looking statements can also be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to, changes in interest rates, general economic and business conditions, the quality or composition of the loan or investment portfolios, the level of nonperforming assets and charge-offs, the local real estate market, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, Federal Deposit Insurance

Table of Contents

Corporation (FDIC) premiums and/or assessments, demand for loan products, deposit flows, competition, and accounting principles, policies and guidelines. Monetary and fiscal policies of the U.S. Government could also adversely affect the Company; such policies include the impact of any regulations or programs implemented pursuant to the Emergency Economic Stabilization Act of 2008 (EESA), the American Recovery and Reinvestment Act of 2009 (ARRA) and other policies of the Office of the Comptroller of the Currency, U.S. Treasury and the Federal Reserve Board.

The Company has experienced losses due to the current economic climate. A continuation of the recent turbulence in significant portions of the global financial markets, particularly if it worsens, could further impact the Company s performance, both directly by affecting revenues and the value of the Company s assets and liabilities, and indirectly by affecting the Company s counterparties and the economy generally. Dramatic declines in the housing market in the past year have resulted in significant write-downs of asset values by the Company as well as by other financial institutions in the U.S. Concerns about the stability of the U.S. financial markets generally have reduced the availability of funding to certain financial institutions, leading to a tightening of credit, reduction of business activity, and increased market volatility.

On May 22, 2009, the FDIC approved a final rule to impose a special assessment of 5 basis points on each bank s total assets minus Tier 1 capital in order to replenish the Deposit Insurance Fund. Additional special assessments are probable later in 2009. These special assessments plus higher quarterly assessments have impacted and will continue to impact the Company s performance by directly affecting expenses.

It is not clear at this time what other impacts the EESA, the ARRA or other liquidity and funding initiatives of the U.S. Treasury and other bank regulatory agencies that have been announced or any additional programs that may be initiated in the future will have on the financial markets and the financial services industry. The extreme levels of volatility and limited credit availability currently being experienced could continue to affect the U.S. banking industry and the broader U.S. and global economies, which would have an effect on all financial institutions, including the Company.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

General

The Company is the parent company of the Bank and Trust. The Bank is a locally managed community bank serving the Hampton Roads localities of Hampton, Newport News, Norfolk, Virginia Beach, Chesapeake, Williamsburg/James City County, York County and Isle of Wight County. The Bank currently has 20 branch offices. Trust is a wealth management services provider.

Critical Accounting Policies and Estimates

As of June 30, 2009, there have been no significant changes with regard to the critical accounting policies and estimates disclosed in the Company s 2008 annual report on Form 10-K. That disclosure included a discussion of the accounting policy that requires management s most difficult, subjective or complex judgments: the allowance for loan losses.

Earnings Summary

Net loss for the second quarter of 2009 was $622 thousand as compared with net income of $1.94 million earned in the second quarter of 2008, a decrease of 132.06%. During the second quarter of 2009, the Company increased its loan loss provision by $2.70 million compared to the second quarter of 2008. In addition, the cost of FDIC insurance dramatically increased over the second quarter of 2008. The increase to the loan loss provision was made to ensure that the Company has adequately provided for loan losses caused by the downturn in the economy and a decline in real estate values. Basic and diluted losses per share for the second quarter of 2009 were $(0.13). Basic and diluted earnings per share for the second quarter of 2008 were $0.40 and $0.39, respectively. For the six months ended June 30, 2009, basic and diluted earnings per share were $0.03. For the six months ended June 30, 2008, basic and diluted earnings per share were $0.80 and $0.79, respectively.

Table of Contents

Net Interest Income

The principal source of earnings for the Company is net interest income. Net interest income is the difference between interest and fees generated by earning assets and interest expense paid to fund them. Changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as their respective yields and rates, have a significant impact on the level of net interest income. The net interest margin is calculated by dividing tax equivalent net interest income by average earning assets. Net interest income, on a fully tax equivalent basis, was $6.79 million in the second quarter of 2009, a decrease of $163 thousand from the second quarter of 2008. The net interest margin was 3.37% in the second quarter of 2009 and 3.55% in the second quarter of 2008. The net interest margin was lower in the second quarter of 2009 as compared to the second quarter of 2008, because the yield on average earning assets decreased 82 basis points while the yield on average interest-bearing liabilities only decreased 76 basis points.

Tax equivalent interest income decreased $1.31 million, or 11.09%, in the second quarter of 2009 compared to the same period of 2008. Average earning assets grew $23.53 million, or 3.01%, compared to the second quarter of 2008. Interest expense decreased $1.15 million, or 23.63%, and average interest-bearing liabilities increased by $16.42 million, or 2.53% in the second quarter of 2009 compared to the same period of 2008. The cost of funding interest-bearing liabilities decreased 76 basis points in the second quarter of 2009 compared to the second quarter of 2008.

The average yield on earning assets and on interest-bearing liabilities both decreased because the Company lowered its rates on loans, interest-bearing deposits and repurchase agreements in response to the action of the Federal Open Market Committee (FOMC) lowering the Federal Funds Target Rate during 2008 from 4.25% to a range of 0.00% to 0.25%. As higher yielding earning assets and interest-bearing liabilities that were booked prior to 2008 mature, they are being replaced with lower yielding earning assets and interest-bearing liabilities.

Net interest income, on a fully tax equivalent basis, was $13.37 million for the six months ended June 30, 2009, a decrease of $233 thousand or 1.71% compared to the same period of 2008. When comparing the first six months of 2009 to the first six months of 2008, the decrease in net interest income is due to the Company s response to the actions of the FOMC, which resulted in the yield on average earning assets to decrease more than the yield on average interest-bearing liabilities.

The following table shows an analysis of average earning assets, interest-bearing liabilities and rates and yields. Nonaccrual loans are included in loans outstanding.

Table of Contents

AVERAGE BALANCE SHEETS, NET INTEREST INCOME* AND RATES*

	For the quarter ended June 30,					
	2009			2008		
	Average Balance	Interest Income/ Expense	Yield/ Rate**	Average Balance	Interest Income/ Expense	Yield/ Rate**
			(in thousands) (unaudited)			
Loans	$ 634,239	$ 9,417	5.94%	$ 614,471	$ 10,111	6.58%
Investment securities:						
Taxable	123,470	710	2.30%	84,714	864	4.08%
Tax-exempt	12,504	234	7.49%	20,348	370	7.28%
Total investment securities	135,974	944	2.78%	105,062	1,234	4.70%
Federal funds sold	16,404	9	0.22%	22,209	113	2.04%
Other investments	19,140	120	2.51%	40,481	341	3.37%
Total earning assets	805,757	$ 10,490	5.21%	782,223	$ 11,799	6.03%
Reserve for loan losses	(6,984)			(5,052)		
Other nonearning assets	66,752			62,841		
Total assets	$ 865,525			$ 840,012		
Time and savings deposits:						
Interest-bearing transaction accounts	$ 9,836	$ 2	0.08%	$ 10,772	$ 3	0.11%
Money market deposit accounts	135,820	79	0.23%	139,974	235	0.67%
Savings accounts	41,857	17	0.16%	37,898	24	0.25%
Time deposits, $100,000 or more	153,660	981	2.55%	123,582	1,263	4.09%
Other time deposits	184,274	1,626	3.53%	204,987	2,086	4.07%
Total time and savings deposits	525,447	2,705	2.06%	517,213	3,611	2.79%
Federal funds purchased, repurchase agreements and other borrowings	73,425	144	0.78%	51,349	214	1.67%
Federal Home Loan Bank advances	66,111	854	5.17%	80,000	1,024	5.12%
Total interest-bearing liabilities	664,983	3,703	2.23%	648,562	4,849	2.99%
Demand deposits	114,575			106,464		
Other liabilities	3,224			3,335		
Stockholders equity	82,743			81,651		
Total liabilities and stockholders equity	$ 865,525			$ 840,012		
Net interest income/yield		$ 6,787	3.37%		$ 6,950	3.55%

	For the six months ended June 30,					
	2009			2008		
	Average Balance	Interest Income/ Expense	Yield/ Rate**	Average Balance	Interest Income/ Expense	Yield/ Rate**
			(in thousands) (unaudited)			
Loans*	$ 634,537	$ 18,850	5.94%	$ 609,151	$ 20,382	6.69%

Investment securities:						
Taxable	107,516	1,370	2.55%	95,763	1,857	3.88%
Tax-exempt *	13,203	475	7.20%	22,141	788	7.12%
Total investment securities	120,719	1,845	3.06%	117,904	2,645	4.49%
Federal funds sold	19,637	22	0.22%	24,841	330	2.66%
Other investments	21,236	267	2.51%	26,265	476	3.62%
Total earning assets	796,129	$ 20,984	5.27%	778,161	$ 23,833	6.13%
Allowance for loan losses	(6,721)			(5,089)		
Other nonearning assets	65,653			58,454		
Total assets	$ 855,061			$ 831,526		
Time and savings deposits:						
Interest-bearing transaction accounts	$ 9,572	$ 4	0.08%	$ 10,426	$ 8	0.15%
Money market deposit accounts	133,471	158	0.24%	140,264	607	0.87%
Savings accounts	40,631	31	0.15%	37,362	58	0.31%
Time deposits, $100,000 or more	144,940	2,032	2.80%	111,791	2,617	4.68%
Other time deposits	194,076	3,403	3.51%	213,657	4,345	4.07%
Total time and savings deposits	522,690	5,628	2.15%	513,500	7,635	2.97%
Federal funds purchased, repurchase agreements and other borrowings	64,008	241	0.75%	52,977	550	2.08%
Federal Home Loan Bank advances	68,056	1,749	5.14%	80,000	2,049	5.12%
Total interest-bearing liabilities	654,754	7,618	2.33%	646,477	10,234	3.17%
Demand deposits	114,152			100,637		
Other liabilities	3,153			3,184		
Stockholders equity	83,002			81,228		
Total liabilities and stockholders equity	$ 855,061			$ 831,526		
Net interest income/yield		$ 13,366	3.36%		$ 13,599	3.50%

* Computed on a fully tax-equivalent basis using a 34% rate

** Annualized

Table of Contents

Provision for Loan Losses

The provision for loan losses is a charge against earnings necessary to maintain the allowance for loan losses at a level consistent with management s evaluation of the portfolio.

The provision for loan losses was $3.00 million in the second quarter of 2009, as compared to $300 thousand in the second quarter of 2008. Net loans charged off were $2.54 million higher in the second quarter of 2009 as compared to the same period in 2008. Net loans charged off in the second quarter of 2009 were impacted by a $1.40 million write-down of a real estate construction project in the second quarter.

The provision for loan losses was $4.00 million for the first six months of 2009, and $600 thousand in the comparable period in 2008. Net loans charged off in the first six months of 2009 were $3.13 million as compared to $617 thousand in the first six months of 2008. On an annualized basis, net loan charge-offs were 0.99% of total loans for the first six months of 2009 compared with 0.20% for the same period in 2008.

Management contributed $4.00 million to the loan loss provision or $870 thousand more than net charge-offs in the first six months of 2009. This additional expense was based on management s estimate of credit losses that may be sustained in the loan portfolio. Management s evaluation included credit quality trends, collateral values, the findings of internal credit quality assessments and results from external bank regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, were used in developing estimated loss factors for determining the loan loss provision.

Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and accruing interest, restructured loans, and other real estate owned. Restructured loans are loans with terms that were modified in a troubled debt restructuring for borrowers experiencing financial difficulties. As of June 30, 2009, all restructured loans were still accruing interest. Other real estate owned is real estate from foreclosures of collateral of loans. $1.22 million of the Company s nonperforming loans consist of loans 90 days past due but still accruing interest, with $1.20 million of such loans secured by real estate. The majority of the loans 90 days past due but still accruing interest are classified as substandard. As noted below, substandard loans are a component of the allowance for loan losses. When a loan changes from 90 days past due but still accruing interest to nonaccrual status, the loan is reviewed for impairment. If the loan is considered impaired, then the difference between the value of the collateral and the principal amount outstanding on the loan is charged off. If the Company is waiting on an appraisal to determine the collateral s value, management allocates funds to cover the deficiency to the allowance for loan losses based on information available to management at the time.

Table of Contents

The following table presents information concerning nonperforming assets as of June 30, 2009 and December 31, 2008:

NONPERFORMING ASSETS

	June 30, 2009 (unaudited)	December 31, 2008
	(in thousands)	
Nonaccrual loans		
Commercial	$ 574	$ 219
Real estate-construction	119	370
Real estate-mortgage	5,152	337
Installment loans to individuals	80	119
Total nonaccrual loans	**$ 5,925**	**$ 1,045**
Loans past due 90 days or more and accruing interest		
Commercial	$ 6	$ 66
Real estate-construction		375
Real estate-mortgage	975	2,744
Installment loans to individuals	226	335
Other	10	9
Total loans past due 90 days or more and accruing interest	**$ 1,217**	**$ 3,529**
Restructured loans (accrual)		
Real estate-construction	$	$ 6,594
Real estate-mortgage	689	
Total restructured loans (accrual)	**$ 689**	**$ 6,594**
Other real estate owned		
Real estate-construction	$ 5,820	$ 1,795
Real estate-mortgage	2,212	1,956
Total other real estate owned	**$ 8,032**	**$ 3,751**
Total nonperforming assets	**$ 15,863**	**$ 14,919**

Nonperforming assets as of June 30, 2009 were $944 thousand higher than at December 31, 2008. As shown in the table above, the nonaccrual loan category increased by $4.88 million and the other real estate owned category increased by $4.28 million. The increase in nonaccrual loans is due to the continuing general decline in the economy overall and the depressed real estate market. The majority of the increase in nonperforming loans was related to a few large credit relationships. Of the $5.93 million of nonaccrual loans at June 30, 2009, $5.36 million or 90.39% was comprised of five credit relationships of $4.52 million, $275 thousand, $199 thousand, $187 thousand and $177 thousand. The increase in other real estate owned was primarily due to one lending relationship of $6.59 million in the real estate-construction portfolio that was classified as restructured loans as of December 31, 2008. During the first quarter of 2009 this relationship was moved to nonaccrual status

and in the second quarter of 2009, $1.40 million was charged off, and the remaining balance was moved to other real estate owned.

Management believes that the increase in nonperforming assets could continue to have a negative effect on the Company s condition if current economic conditions do not improve. As was seen in the quarter ended June 30, 2009, the effect would be lower earnings caused by larger contributions to the loan loss provision arising from a larger impairment in the loan portfolio and a higher level of loan charge-offs. Management believes the Company has excellent credit quality review processes in place to identify problem loans quickly. Management will work with customers that are having difficulties meeting their loan payments. The last resort is foreclosure.

As reflected in the $944 thousand increase in nonperforming assets during the first six months of 2009, the quality of the Company s loan portfolio declined. Due to this decline, management has increased the allowance for loan losses to $7.27 million as of June 30, 2009 as compared to a balance of $6.41 million as

of December 31, 2008. As of June 30, 2009, the allowance for loan losses was 45.86% of nonperforming assets and 92.90% of nonperforming loans. The definition of nonperforming loans is nonperforming assets less other real estate owned. The allowance for loan losses was 1.15% of total loans on June 30, 2009 and 1.00% of total loans on December 31, 2008.

Allowance for Loan Losses

The allowance for loan losses is based on several components. In evaluating the adequacy of the allowance, the loan portfolio is divided into several pools of loans:

1. Doubtful under SFAS No. 114, Accounting by Creditors for Impairment of a Loan (SFAS 114)
2. Substandard under SFAS 114
3. Pool substandard
4. Pool other assets especially mentioned (rated just above substandard)