FAUQUIER BANKSHARES, INC.
Form 10-Q
August 07, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)

þ **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

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________to__________

Commission File No.: 000-25805
Fauquier Bankshares, Inc.
(Exact name of registrant as specified in its charter)

Virginia	**54-1288193**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10 Courthouse Square, Warrenton, Virginia	**20186**
(Address of principal executive offices)	(Zip Code)

(540) 347-2700
(Registrant s telephone number, including area code)

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

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 o No o

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

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

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

The registrant had 3,596,537 shares of common stock outstanding as of August 5, 2009.

FAUQUIER BANKSHARES, INC.
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Part I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Fauquier Bankshares, Inc. and Subsidiaries
Consolidated Balance Sheets

	June 30, 2009 (Unaudited)	December 31, 2008 (Audited)
Assets		
Cash and due from banks	$ 4,964,168	$ 7,698,661
Interest-bearing deposits in other banks	4,433,033	3,324,501
Federal funds sold	11,043	
Securities available for sale	36,385,418	37,839,375
Loans, net of allowance for loan losses of $5,090,838 in 2009 and $4,779,662 in 2008	452,132,379	434,678,433
Bank premises and equipment, net	11,006,374	8,621,217
Accrued interest receivable	1,424,287	1,549,597
Other real estate owned	2,029,085	3,034,470
Other assets	18,448,587	17,768,978
Total assets	$ 530,834,374	$ 514,515,232
Liabilities and Shareholders Equity		
Deposits:		
Noninterest-bearing	57,784,661	69,065,944
Interest-bearing:		
NOW accounts	75,117,520	74,555,901
Savings and money market accounts	109,280,344	102,810,758
Time certificates of deposit	170,418,126	153,861,028
Total interest-bearing	354,815,990	331,227,687
Total deposits	412,600,651	400,293,631
Federal funds purchased	21,800,000	18,275,000
Federal Home Loan Bank advances	45,000,000	45,000,000
Company-obligated mandatorily redeemable capital securities	4,124,000	4,124,000
Other liabilities	5,920,347	5,334,664
Commitments and contingencies		
Total liabilities	489,444,998	473,027,295
Shareholders Equity		
Common stock, par value, $3.13; authorized 8,000,000 shares: issued and outstanding, 2009: 3,596,537 shares (includes nonvested shares of 51,134); 2008: 3,564,317 shares (includes nonvested shares of 38,219)	11,097,111	11,036,687
Retained earnings	33,049,924	32,668,530

Accumulated other comprehensive income (loss), net	(2,757,659)	(2,217,280)
Total shareholders equity	41,389,376	41,487,937
Total liabilities and shareholders equity	$ 530,834,374	$ 514,515,232

See accompanying Notes to Consolidated Financial Statements.

Fauquier Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income
(Unaudited)
For the Three Months Ended June 30, 2009 and 2008

	2009	2008
Interest Income		
Interest and fees on loans	$ 6,486,153	$ 6,590,186
Interest and dividends on securities available for sale:		
Taxable interest income	315,979	334,172
Interest income exempt from federal income taxes	57,925	58,187
Dividends	15,765	70,118
Interest on federal funds sold	49	4,452
Interest on deposits in other banks	3,309	4,488
Total interest income	6,879,180	7,061,603
Interest Expense		
Interest on deposits	1,440,997	1,649,515
Interest on federal funds purchased	12,400	29,872
Interest on Federal Home Loan Bank advances	229,694	469,438
Distribution on capital securities of subsidiary trusts	29,385	45,463
Total interest expense	1,712,476	2,194,288
Net interest income	5,166,704	4,867,315
Provision for loan losses	360,000	834,000
Net interest income after provision for loan losses	4,806,704	4,033,315
Other Income		
Wealth management income	245,588	331,821
Service charges on deposit accounts	718,944	751,368
Other service charges, commissions and income	414,082	664,000
(Loss) on impairment of securities	(166,388)	(125,000)
Gain on sale of other real estate owned		28,718
Total other income	1,212,226	1,650,907
Other Expenses		
Salaries and benefits	2,330,671	2,298,802
Net occupancy expense of premises	318,242	347,931
Furniture and equipment	268,831	285,035

Marketing expense	187,380	155,854
Legal, audit, and consulting expense	476,961	260,707
Data processing expense	325,429	329,697
Other operating expenses	1,115,722	717,362
Total other expenses	5,023,236	4,395,388
Income before income taxes	995,694	1,288,834
Income tax expense	272,013	346,420
Net Income	$ 723,681	$ 942,414
Earnings per Share, basic	$ 0.20	$ 0.27
Earnings per Share, assuming dilution	$ 0.20	$ 0.26
Dividends per Share	$ 0.20	$ 0.20

See accompanying Notes to Consolidated Financial Statements.

Fauquier Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income
(Unaudited)
For the Six Months Ended June 30, 2009 and 2008

	2009	2008
Interest Income		
Interest and fees on loans	$ 12,846,384	$ 13,388,785
Interest and dividends on securities available for sale:		
Taxable interest income	672,142	661,678
Interest income exempt from federal income taxes	119,386	116,411
Dividends	20,228	123,120
Interest on federal funds sold	156	33,293
Interest on deposits in other banks	6,978	12,546
Total interest income	13,665,274	14,335,833
Interest Expense		
Interest on deposits	2,999,773	3,723,725
Interest on federal funds purchased	22,846	63,359
Interest on Federal Home Loan Bank advances	496,361	881,475
Distribution on capital securities of subsidiary trusts	65,220	109,705
Total interest expense	3,584,200	4,778,264
Net interest income	10,081,074	9,557,569
Provision for loan losses	560,000	1,290,000
Net interest income after provision for loan losses	9,521,074	8,267,569
Other Income		
Wealth management income	497,044	675,237
Service charges on deposit accounts	1,326,120	1,459,965
Other service charges, commissions and income	836,270	1,092,981
Gain on sale of securities		87,585
(Loss) on impairment of securities	(166,388)	(125,000)
Gain (Loss) on sale of other real estate owned	(135,759)	28,718
Total other income	2,357,287	3,219,486
Other Expenses		
Salaries and benefits	4,685,610	4,627,026
Net occupancy expense of premises	625,309	630,326

Furniture and equipment	549,281	571,542
Advertising expense	308,358	325,596
Legal, audit, and consulting expense	812,904	541,388
Data processing expense	673,923	662,342
Other operating expenses	1,962,818	1,432,762
Total other expenses	9,618,203	8,790,982
Income before income taxes	2,260,158	2,696,073
Income tax expense	613,568	745,153
Net Income	$ 1,646,590	$ 1,950,920
Earnings per Share, basic	$ 0.46	$ 0.55
Earnings per Share, assuming dilution	$ 0.46	$ 0.55
Dividends per Share	$ 0.40	$ 0.40

Fauquier Bankshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders Equity
For the Six Months Ended June 30, 2009 and 2008

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Total
Balance, December 31, 2007	$ 10,974,293	$ 31,626,627	$ (773,168)		$ 41,827,752
Comprehensive income:					
Net income		1,950,920		$ 1,950,920	1,950,920
Other comprehensive income net of tax:					
Unrealized holding gains on securities available for sale, net of tax benefit of $414,444				(804,508)	
Add: reclassification adjustments, net of tax benefit of $12,721				24,694	
Other comprehensive income net of tax of $401,723			(779,814)	(779,814)	(779,814)
Total comprehensive income				$ 1,171,106	
Effects of changing pension plan measurement date, pursuant to FAS 158, net of deferred income tax benefit of $12,437		(24,144)			(24,144)
Initial implementation of EITF 06-4, net of income tax benefit of $6,433		(12,487)			(12,487)
Cash dividends ($.40 per share)		(1,427,573)			(1,427,573)
Acquisition of 4,293 shares of common stock	(13,437)	(62,725)			(76,162)
Amortization of unearned compensation, restricted stock awards		175,275			175,275
Restricted Stock forfeiture		(49,604)			(49,604)
Issuance of common stock nonvested shares (9,763 shares)	30,558	(30,558)			
Exercise of stock options	59,220	128,300			187,520
Balance, June 30, 2008	$ 11,050,634	$ 32,274,031	$ (1,552,982)		$ 41,771,683

Balance, December 31, 2008	$ 11,036,687	$ 32,668,530	$ (2,217,280)		$ 41,487,937
Comprehensive income:					
Net income		1,646,590		1,646,590	1,646,590
Other comprehensive income net of tax:					
Unrealized holding losses on securities available for sale, net of tax benefit of $334,949				(650,195)	
Add: reclassification adjustments, net of tax benefit of $56,572				109,816	
Other comprehensive income net of tax of $278,377			(540,379)	(540,379)	(540,379)
Total comprehensive income				1,106,211	
Cash dividends ($.40 per share)		(1,438,615)			(1,438,615)
Amortization of unearned compensation, restricted stock awards		152,063			152,063
Issuance of common stock nonvested shares (10,585 shares)	33,131	(33,131)			
Exercise of stock options	27,293	54,487			81,780
Balance, June 30, 2009	$ 11,097,111	$ 33,049,924	$ (2,757,659)		$ 41,389,376

Fauquier Bankshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Six Months Ended June 30, 2009 and 2008
(Unaudited)

	2009	2008
Cash Flows from Operating Activities		
Net income	$ 1,646,590	$ 1,950,920
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	404,070	466,498
Provision for loan losses	560,000	1,290,000
Loss on sale of other real estate	135,759	
Loss on impairment of securities	166,388	125,000
(Gain) on sale of securities		(87,585)
Amortization (accretion) of security premiums, net	(20,186)	(3,185)
Amortization of unearned compensation, net of forfeiture	152,063	125,670
Changes in assets and liabilities:		
(Increase) decrease in other assets	(275,387)	26,593
(Decrease) increase in other liabilities	585,683	(548,485)
Net cash provided by operating activities	3,354,980	3,345,426
Cash Flows from Investing Activities		
Proceeds from sale of securities available for sale		9,078,470
Proceeds from maturities, calls and principal payments of securities available for sale	4,804,868	2,472,159
Purchase of securities available for sale	(3,596,504)	(13,962,499)
Purchase of premises and equipment	(2,789,227)	(1,771,104)
(Purchase) proceeds from sale of other bank stock	(719,900)	(1,292,300)
Net (increase) decrease in loans	(18,013,946)	(17,316,978)
Proceeds from sale of other real estate owned	869,626	
Net cash provided by (used in) investing activities	(19,445,083)	(22,792,252)
Cash Flows from Financing Activities		
Net (decrease) increase in demand deposits, NOW accounts and savings accounts	(4,250,078)	(10,351,899)
Net (decrease) increase in certificates of deposit	16,557,098	(5,966,100)
Federal Home Loan Bank advances	150,000,000	65,000,000
Federal Home Loan Bank principal repayments	(150,000,000)	(35,000,000)
Purchase of federal funds, net	3,525,000	
Cash dividends paid on common stock	(1,438,615)	(1,427,573)
Issuance of common stock	81,780	187,521
Acquisition of common stock		(76,161)
Net cash provided by financing activities	14,475,185	12,365,788

(Decrease) in cash and cash equivalents		(1,614,918)		(7,081,038)
Cash and Cash Equivalents				
Beginning		11,023,162		19,552,174
Ending	$	9,408,244	$	12,471,136
Supplemental Disclosures of Cash Flow Information				
Cash payments for:				
Interest	$	3,726,758	$	5,006,550
Income taxes	$	635,000	$	380,000
Supplemental Disclosures of Noncash Investing Activities				
Unrealized (loss) on securities available for sale, net of tax effect	$	(540,379)	$	(804,508)
FAS 158 Pension Liability Implementation Adjustment, net of tax effect	$		$	(24,144)
Implementation of EITF 06-4, net of tax effect	$		$	(12,487)

FAUQUIER BANKSHARES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

Note 1. General

The consolidated statements include the accounts of Fauquier Bankshares, Inc. (the Company) and its wholly-owned subsidiaries: The Fauquier Bank (the Bank) and Fauquier Statutory Trust II; and the Bank s wholly-owned subsidiary, Fauquier Bank Services, Inc. In consolidation, significant intercompany financial balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial positions as of June 30, 2009 and December 31, 2008 and the results of operations for the three and six months ended June 30, 2009 and 2008. The notes included herein should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company s 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the results expected for the full year.

Note 2. Securities

The amortized cost and fair value of securities available for sale, with unrealized gains and losses follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
	June 30, 2009			
Obligations of U.S. Government corporations and agencies	$ 24,024,239	$ 687,302	$ (2,285)	$ 24,709,256
Obligations of states and political subdivisions	5,569,318	21,800	(144,954)	5,446,164
Corporate Bonds	5,946,532		(3,807,939)	2,138,593
Mutual Funds	308,890		(3,685)	305,205
FHLMC Preferred Bank Stock	18,500		(7,000)	11,500
Restricted investments:				
Federal Home Loan Bank Stock	3,625,700			3,625,700
Federal Reserve Bank Stock	99,000			99,000
Community Bankers Bank Stock	50,000			50,000
	$ 39,642,179	$ 709,102	$ (3,965,863)	$ 36,385,418

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
	December 31, 2008			
Obligations of U.S. Government corporations and agencies	$ 25,212,561	$ 561,884	$ (2,030)	$ 25,772,415
Obligations of states and political subdivisions	5,574,709	29,033	(146,019)	5,457,723
Corporate Bonds	6,000,000		(2,861,903)	3,138,097
Mutual Funds	303,889		(5,969)	297,920
FHLMC Preferred Bank Stock	18,500		(13,000)	5,500
Restricted investments:				

Federal Home Loan Bank Stock	2,905,800			2,905,800
Federal Reserve Bank Stock	99,000			99,000
Community Bankers Bank Stock	50,000			50,000
Silverton Bank Stock	112,920			112,920
	$ 40,277,379	$ 590,917	$ (3,028,921)	$ 37,839,375

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

	June 30, 2009	
	Amortized Cost	Fair Value
Due in one year or less	$ 576,038	$ 584,367
Due after one year through five years	191,864	197,199
Due after five years through ten years	9,946,551	10,186,570
Due after ten years	24,825,636	21,325,877
Equity securities	4,102,090	4,091,405
	$ 39,642,179	$ 36,385,418

During the three and six months ended June 30, 2009, the Company recognized a permanent impairment of $112,920 on its 50 shares of Silverton Bank common stock. No tax benefit has been recognized on this impairment loss. In addition, during the three and six months ended June 30, 2009, the Company recognized a permanent impairment of $53,468 on its investment in pooled trust preferred securities. A tax benefit of $18,179 has been recognized on this impairment loss.

During the three and six months ended June 30, 2008, the Bank recognized a permanent impairment of $125,000 on its 10,000 shares of Freddie Mac preferred stock. A tax benefit of $42,500 was recognized on this impairment loss during the quarter ended September 30, 2008.

There were no securities sold in the three and six months ended June 30, 2009, or for the three months ended June 30, 2008. For the six months ended June 30, 2008, gross realized gains from sales of securities available for sale amounted to $87,585. The proceeds from the sale of these securities, including the realized gain, amounted to $9.1 million. The tax expense applicable to this net realized gain amounted to $29,779.

The following table shows the Company securities with gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2009 and December 31, 2008, respectively.

June 30, 2009	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Obligations of U.S. Government, corporations and agencies	$ 2,008,085	$ (2,285)	$	$	$ 2,008,085	$ (2,285)
Obligations of states and political subdivisions	2,283,202	(62,705)	2,079,715	(82,249)	4,362,917	(144,954)
Corporate Bonds			2,138,593	(3,807,939)	2,138,593	(3,807,939)
Subtotal, debt securities	4,291,287	(64,990)	4,218,308	(3,890,188)	8,509,595	(3,955,178)
Mutual Funds			305,205	(3,685)		(3,685)
FHLMC Preferred Bank Stock	11,500	(7,000)			11,500	(7,000)

Total temporary impaired securities	$ 4,302,787	$ (71,990)	$ 4,523,513	$ (3,893,873)	$ 8,521,095	$ (3,965,863)

December 31, 2008	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Obligations of U.S. Government, corporations and agencies	$ 785,744	$ (2,030)	$	$	785,744	$ (2,030)
Obligations of states and political subdivisions	4,181,657	(146,019)			4,181,657	(146,019)
Corporate Bonds			3,138,097	(2,861,903)	3,138,097	(2,861,903)
Subtotal, debt securities	4,967,401	(148,049)	3,138,097	(2,861,903)	8,105,498	(3,009,952)
Mutual Funds			297,920	(5,969)	297,920	(5,969)
FHLMC Preferred Bank Stock	5,500	(13,000)			5,500	(13,000)
Total temporary impaired securities	$ 4,972,901	$ (161,049)	$ 3,436,017	$ (2,867,872)	$ 8,408,918	$ (3,028,921)

The nature of securities which are temporarily impaired for a continuous 12 month period or more at June 30, 2009 can be segregated into three groups:

The first group consists of four corporate bonds with a cost basis totaling $5.95 million and a temporary loss of approximately $3.8 million. The method for valuing these four corporate bonds came from Moody s Analytics. Moody s Analytics employs a two step discounted cash-flow valuation process. The first step is to use Monte Carlo simulations to evaluate the credit quality of the collateral pool and the structural supports. Step two is to apply a discount rate to the cash flows to calculate a value. These four corporate bonds are the Class B or subordinated mezzanine tranche of pooled trust preferred securities. The trust preferred securities are collateralized by the interest and principal payments made on trust preferred capital offerings by a geographically diversified pool of approximately 50 different financial institutions. They have an estimated maturity of 26 years, but can be called at par on the five year anniversary, which already passed for three bonds, and will occur in September 2009 for the other bond. If not called, the bonds reprice every three months at a fixed rate index above the three-month London Interbank Offered Rate (LIBOR). These bonds are current, they have sufficient collateralization and cash flow projections to satisfy their valuation based on the cash flow portion of the Other Than Temporary Impairment (OTTI) test under Emerging Issues Task Force No. 99-20-1 as of June 30, 2009. Additional information regarding each of the pooled trust preferred securities as of June 30, 2009 follows:

Cost, net of OTTI loss	Fair Value	Percent of Underlying Collateral Performing	Percent of Underlying Collateral in Deferral	Percent of Underlying Collateral in Default	Current Moody s Rating	Estimate of additional deferrals/defaults before temporary or permanent shortfall in cashflow
$946,532	$250,980	75.3%	21.9%	2.8%	Ca	0.0%
2,000,000	846,328	85.6%	13.9%	0.5%	Ca	13.5%
2,000,000	806,979	89.3%	9.6%	1.1%	Ca	16.1%
1,000,000	234,306	82.7%	12.3%	5.0%	Ca	8.0%

The second group consists of five municipal bonds totaling $2.1 million with a temporary loss of $82,000. These bonds are current and all have investment grade credit ratings ranging from A2 to Baa1 from Standard & Poors and/or Moody s. The Company plans to hold them until their respective maturities in 2020 and 2021.

The third group consists of a Community Reinvestment Act qualified investment bond fund with a temporary loss of approximately $4,000. The fund is a relatively small balance of the portfolio and the Company plans to hold it indefinitely.

The carrying value of securities pledged to secure deposits and for other purposes amounted to $23.8 million and $25.9 million at June 30, 2009 and December 31, 2008, respectively.

Note 3. Loans

A summary of the balances of loans follows:

	June 30, 2009	December 31, 2008
	(Thousands)	
Real estate loans:		
Construction	$ 41,899	$ 38,037
Secured by farmland	1,268	1,293
Secured by 1 - to - 4 family residential	182,800	175,791
Other real estate loans	172,559	160,443
Commercial and industrial loans (not secured by real estate)	39,406	39,985
Consumer installment loans	13,151	15,695
All other loans	6,979	8,934
Total loans	$ 458,062	$ 440,178
Unearned income	(839)	(720)
Allowance for loan losses	(5,091)	(4,780)
Net loans	$ 452,132	$ 434,678

Of the $172.5 million in other real estate loans at June 30, 2009, $101.7 million were owner occupied. Of the $160.4 million in other real estate loans at December 31, 2008, $96.2 million were owner occupied.

Note 4. Allowance for Loan Losses

Analysis of the allowance for loan losses follows:

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008	Twelve Months Ended December 31, 2008
Balance at beginning of year	$ 4,779,662	$ 4,185,209	$ 4,185,209
Provision for loan losses	560,000	1,290,000	3,227,269
Recoveries of loans previously charged-off	45,203	30,629	72,298
Loan losses charged-off	(294,028)	(1,186,532)	(2,705,114)
Balance at end of year	$ 5,090,837	$ 4,319,306	$ 4,779,662

Nonperforming assets consist of the following:

	June 30,	December 31,	June 30,

(Dollars in thousands)	2009	2008	2008
Nonaccrual loans	$ 1,139	$ 1,208	$ 2,956
Restructured loans			
Total nonperforming loans	$ 1,139	$ 1,208	$ 2,956
Other real estate owned	2,029	3,034	
Foreclosed property	51	33	56
Total nonperforming assets	$ 3,219	$ 4,275	$ 3,012
Allowance for loan losses to period end loans	1.11%	1.08%	1.02%
Non-performing assets to period end loans and repossessed assets owned	0.70%	0.97%	0.70%
Non-performing assets to period end total assets	0.61%	0.81%	0.60%

	June 30, 2009	December 31, 2008	June 30, 2008
Impaired loans for which an allowance has been provided	$ 2,080,567	$ 809,221	$ 1,407,864
Impaired loans for which no allowance has been provided	180,361	81,604	2,160,361
	$ 2,260,928	$ 890,825	$ 3,568,225
Allowance provided for impaired loans, included in the allowance for loan losses	$ 1,080,071	$ 720,395	$ 1,136,167

	Three Months Ended June 30, 2009	Twelve Months Ended December 31, 2008	Three Months Ended June 30, 2008
Average balance in impaired loans	$ 2,278,436	$ 1,308,909	$ 3,842,355
Interest income recognized on impaired loans	$ 42,231	$ 35,940	$ 89,152

Total loans past due 90 days or more and still accruing interest were $780,000 at June 30, 2009, and $102,000 and $9,000 on December 31, 2008 and June 30, 2008, respectively. Of the $780,000 at June 30, 2009, $774,000 consisted of five separate lending relationships, ranging from $320,000 to $22,000. These loans were well collateralized and/or were in the process of collection at June 30, 2009.

The Company has adopted Financial Accounting Standards Board (FASB) Statement No. 114, Accounting by Creditors for Impairment of a Loan, as amended by FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures. FASB Statement No. 114, as amended, requires that the impairment of loans that have been separately identified for evaluation is to be measured based on the present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment is to be based on the net realizable value of the collateral. FASB Statement No. 114, as amended, also requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans.

A loan is considered impaired when it is probable that the Bank will be unable to collect all principal and interest amounts according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, expected future cash flows, financial condition of the borrower, and the current economic conditions. A performing loan may be considered impaired if the factors above indicate a need for impairment. A loan on non-accrual status may not be impaired if it is in the process of collection or if the shortfall in payment is insignificant. A delay of less than 30 days or a shortfall of less than 5% of the required principal and interest payments generally is considered insignificant and would not indicate an impairment situation, if in management s judgment the loan will be paid in full. Loans that meet the regulatory definitions of doubtful or loss generally qualify as impaired loans under FASB Statement No. 114. As is the case for all loans, charge-offs for impaired loans occur when the loan or portion of the loan is determined to be uncollectible.

Note 5. Company-Obligated Mandatorily Redeemable Capital Securities

On September 21, 2006, the Company s wholly-owned Connecticut statutory business trust privately issued $4 million face amount of the trust s Floating Rate Capital Securities in a pooled capital securities offering (Trust II). Simultaneously, the trust used the proceeds of that sale to purchase $4.0 million principal amount of the Company s Floating Rate Junior Subordinated Deferrable Interest Debentures due 2036. The interest rate on the capital security resets every three months at 1.70% above the then current three month LIBOR. Interest is paid quarterly.

Total capital securities at June 30, 2009 and December 31, 2008 were $4,124,000 for both respective dates. The Trust II issuance of capital securities and the respective subordinated debentures are callable at any time after

five years from the issue date. The subordinated debentures are an unsecured obligation of the Company and are junior in right of payment to all present and future senior indebtedness of the Company. The capital securities are guaranteed by the Company on a subordinated basis.

Note 6. Earnings Per Share

The following table shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of dilutive potential common stock. Dilutive potential common stock had no effect on income available to common shareholders.

	Three Months Ended June 30, 2009		Three Months Ended June 30, 2008	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	3,596,537	$ 0.20	3,531,310	$ 0.27
Effect of dilutive securities, stock-based awards	9,992		32,516	
	3,606,529	$ 0.20	3,563,826	$ 0.26

	Six Months Ended June 30, 2009		Six Months Ended June 30, 2008	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	3,588,845	$ 0.46	3,523,392	$ 0.55
Effect of dilutive securities, stock-based awards	7,324		34,483	
	3,596,169	$ 0.46	3,557,875	$ 0.55

Shares not included in the calculation above because their effects were not dilutive totaled 23,732 at June 30, 2009 and no shares were excluded at June 30, 2008.

Note 7. Stock-Based Compensation

The Company s 2009 Stock Incentive Plan (Plan) provides for the granting of incentive stock options, restricted stock, and phantom stock units to key employees. The Plan replaced the Omnibus Stock Ownership and Long Term Incentive Plan filed with the Securities and Exchange Commission on October 15, 2002, and became effective on May 19, 2009 after shareholders approved the plan at the annual meeting of shareholders. The Plan makes available 350,000 shares, which may be awarded to directors and employees of the Company in the form of equity-based awards.

Effective January 1, 2006 the Company adopted the provisions of Statement of Financial Accounting Standard (SFAS) No. 123 (R), Share-Based Payment, which requires that the Company recognize expense related to the fair value of stock-based compensation awards in net income.

The non-vested shares are accounted for using the fair market value of the Company s common stock on the date the restricted shares were awarded. The restricted shares issued to executive officers and directors are subject to a vesting period over the next three years. Compensation expense for non-vested shares amounted to $66,774 and $63,401, net of any forfeiture, for the three months ended June 30, 2009 and 2008, respectively. Compensation expense for non-vested shares amounted to $152,063 and $125,671, net of any forfeiture, for the six months ended June 30, 2009 and 2008, respectively.

The Company did not grant stock options during the six months ended June 30, 2009 or June 30, 2008.

A summary of the status of the Omnibus Stock Ownership and Long-Term Incentive Plan and Non-employee Director Stock Option Plan (collectively, the Plans) is presented below:

		Six Months Ended June 30, 2009	
	Number of Shares	**Weighted Average Exercise Price**	**Average Intrinsic Value (1)**
Outstanding at January 1, 2009	77,180	$ 9.84	
Granted			
Exercised	(8,720)	9.38	
Expired	(3,980)	9.75	
Outstanding at June 30, 2009	64,480	$ 9.89	
Exercisable at end of quarter	64,480	$ 9.90	$ 290,651
Weighted-average fair value per option of options granted during the year			

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(1) The aggregate intrinsic value of stock options in the table above reflects the pre-tax intrinsic value (the amount by which the June 30, 2009 market value of the underlying stock option exceeded 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 the changes in the market value of the Company s stock.

The total intrinsic value of options exercised during the six months ended June 30, 2009 and 2008 was $22,478 and $132,774, respectively.

A summary of the status of the Company s non-vested restricted shares is presented below:

	Six Months Ended June 30, 2009	
	Number of Shares	Weighted Average Price
Nonvested at January 1, 2009	38,219	
Granted	23,500	$ 10.05
Vested	(10,585)	
Nonvested at June 30, 2009	51,134	

As of June 30, 2009, there was $418,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over an approximate period of 32 months.

The Company issued 15,050 non-vested phantom stock units at June 30, 2009. These units were awarded to members of senior management, and will fully vest on January 1, 2012 if certain Company earnings performance measures are achieved. When fully vested, each stock unit will be exchanged for one share of Fauquier Bankshares, Inc. common stock. For the three and six month periods ended June 30, 2009, $27,000 and $39,000, respectively, of expense was recognized related to the phantom stock units. As of June 30, 2009 approximately $184,000 of additional compensation cost related to non-vested phantom stock units are expected to be recognized over an approximate period of 30 months.

Note 8. Employee Benefit Plan

The following table provides a reconciliation of the changes in the defined benefit pension plan s obligations for the three and six months ended June 30, 2009 and 2008.

	Three Months Ended June 30,	
	2009	2008
Service cost	$ 62,707	$ 111,081
Interest cost	73,827	77,352
Expected return on plan assets	(65,839)	(149,050)
Amortization of transition (asset)		(4,745)
Amortization of prior service cost		1,942
Recognized net actuarial loss		
Net periodic benefit cost	$ 70,695	$ 36,580

	Six Months Ended June 30,	
	2009	2008
Service cost	$ 125,414	$ 222,162
Interest cost	147,654	154,704
Expected return on plan assets	(130,868)	(298,100)
Amortization of transition (asset)		(9,490)
Amortization of prior service cost		3,884
Recognized net actuarial loss		
Net periodic benefit cost	$ 142,200	$ 73,160

The Company previously disclosed in its financial statements for the year ended December 31, 2008, that there were no contributions made to its pension plan in 2008. As of June 30, 2009, the pension plan required no additional contributions.

On December 20, 2007, the Company s Board of Directors approved the termination of the defined benefit pension plan effective on December 31, 2009, and effective January 1, 2010, the Company will replace the defined benefit pension plan with an enhanced 401(k) plan. On January 18, 2008, the assets within the defined benefit pension plan were redeployed from ownership in various equity and debt mutual fund investments, and into a short-term money market fund in order to preserve asset value until the plan is terminated.

Defined benefit pension plan expenses are projected to be approximately $285,000 in 2009 and nothing due to curtailment going forward. Expenses for the 401(k) plan are projected to increase from approximately $154,000 in 2009 to approximately $625,000 in 2010. Growth in 401(k) after 2010 is projected to increase approximately at the same rate of increase as salaries.

Note 9. Fair Value Measurement

The Company adopted SFAS No. 157, Fair Value Measurements (SFAS 157), on January 1, 2008 to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. SFAS 157 clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

In October of 2008, the FASB issued Staff Position No. 157-3 (FSP 157-3) to clarify the application of SFAS 157 in a market that is not active and to provide key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements were not issued.

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.

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).

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 Using		
(In Thousands) Description	**Balance at June 30, 2009**	**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	$36,385	$ 34,246	$ 2,139	$

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with accounting principles generally accepted in the United States (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:

Loans held for sale: Loans held for sale are carried at the lower of cost or market value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. The Company had no loans held for sale as of June 30, 2009.

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 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 receivables 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 provision for loan losses on the Consolidated Statements of Income.

Certain assets such as other real estate owned are measured at fair value less the cost to sell. Management believes that the fair value component in its valuation follows the provisions of SFAS 157.

Fair values of financial instruments

The Company implemented FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments at June 30, 2009, which requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. 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. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents

The carrying amounts of cash and short-term instruments approximate fair value.

Securities

For securities and marketable equity securities held for investment purposes, fair values are based on quoted market prices or dealer quotes. For other securities held as investments, fair value equals quoted market price, if available. If a quoted market price is not available, fair values are based on quoted market prices for similar securities. See Note 2 Securities of the

Notes to Consolidated Financial Statements for further discussion on determining fair value for pooled trust preferred securities.

Loan Receivables

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one-to-four family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (i.e., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposit Liabilities

The fair values disclosed for demand deposits (i.e., interest and non-interest bearing checking, statement savings and money market accounts) are, by definition, equal to the amount payable at the reporting date (that is, their carrying amounts). Fair values of fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly maturities on time deposits.

Federal Funds Purchased

The carrying amounts of the Company s federal funds purchased are approximate fair value.

Federal Home Loan Bank Advances

The fair values of the Company s FHLB advances are estimated using discounted cash flow analyses based on the Company s current incremental borrowing rates for similar types of borrowing arrangements.

Off-Balance-Sheet Financial Instruments

The fair value of commitments to extend credit is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The fair value of standby letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

At June 30, 2009 and December 31, 2008, the fair value of loan commitments and standby letters of credit were deemed immaterial.

The estimated fair values of the Company s financial instruments are as follows:

(In Thousands)	June 30, 2009 Carrying Amount	June 30, 2009 Fair Value	December 31, 2008 Carrying Amount	December 31, 2008 Fair Value
Financial assets:				
Cash and short-term investments	$ 9,397	$ 9,397	$ 11,023	$ 11,023
Federal funds sold	11	11		
Securities	36,385	36,385	37,839	37,839
Loans, net	452,132	458,809	434,678	452,946
Accrued interest receivable	1,424	1,424	1,550	1,550
Financial liabilities:				
Deposits	$412,601	$414,107	$400,294	$402,589
FHLB advances	45,000	45,521	45,000	46,037
Federal funds purchased	21,800	21,800	18,275	18,275
Company obligated mandatorily redeemable capital securities	4,124	2,571	4,124	3,116
Accrued interest payable	720	720	863	863

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company s financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company s overall interest rate risk.

Note 10: Subsequent Events

The Company adopted the Statement of Financial Accounting Standards (SFAS) No. 165, *Subsequent Events*. SFAS No. 165 establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that should be made about events or transactions that occur after the balance sheet date. In preparing these financial statements, the Company evaluated the events and transactions that occurred between June 30, 2009 through August 7, 2009, the date these financial statements were issued.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

In addition to the historical information contained herein, this report contains forward-looking statements. Forward-looking statements are based on certain assumptions and describe future plans, strategies, and expectations of the Company and the Bank, and are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project may, will or similar expressions. Although we believe our plans, intentions and expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these plans, intentions, or expectations will be achieved. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain, and actual results could differ materially from those contemplated. Factors that could have a

material adverse effect on our operations and future prospects include, but are not limited to, changes in: interest rates, general economic conditions, the legislative/regulatory climate, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury, the FDIC and the Board of Governors of the Federal Reserve System, the quality or composition of the Bank s loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in our market area, our plans to expand our branch network and increase our market share, and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements in this report and you should not place undue reliance on such statements, which reflect our position as of the date of this report.

For additional discussion of risk factors that may cause our actual future results to differ materially from the results indicated within forward-looking statements, please see Risk Factors in Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

CAUTIONARY STATEMENT REGARDING NON-GAAP MEASURES

This report contains financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America (GAAP). The Company s management uses these non-GAAP measures in their analysis of the Corporation s performance. The Company s management believes that these non-GAAP financial measures provide a greater understanding of ongoing operations and enhance comparability of results with prior periods as well as demonstrating the effects of significant gains and charges in the current period. The Company believes that a meaningful analysis of its financial performance requires an understanding of the factors underlying that performance. The Company s management believes that investors may use these non-GAAP financial measures to analyze financial performance without the impact of unusual items that may obscure trends in the Company s underlying performance. Where incorporated into our disclosures, these non-GAAP measures will be clearly identified as such. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

GENERAL

Fauquier Bankshares, Inc. (the Company) was incorporated under the laws of the Commonwealth of Virginia on January 13, 1984. The Company is a registered bank holding company and owns all of the voting shares of The Fauquier Bank (the Bank). The Company engages in its business through the Bank, a Virginia state-chartered bank that commenced operations in 1902. The Company has no significant operations other than owning the stock of the Bank. The Company had issued and outstanding 3,596,537 shares of common stock, par value $3.13 per share, held by approximately 434 holders of record on June 30, 2009. The Bank has nine full service branch offices located in the Virginia communities of Warrenton, Catlett, The Plains, Sudley Road-Manassas, Old Town-Manassas, New Baltimore, Bealeton and Bristow. The executive offices of the Company and the main office of the Bank are located at 10 Courthouse Square, Warrenton, Virginia 20186. The Bank has leased property in Haymarket, Virginia, where it plans to build its tenth full-service branch offices, scheduled to open during 2010.

The Bank s general market area principally includes Fauquier County, western Prince William County, and neighboring communities and is located approximately fifty (50) miles southwest of Washington, D.C.

The Bank provides a range of consumer and commercial banking services to individuals, businesses and industries. The deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (FDIC). The basic services offered by the Bank include: demand interest bearing and non-interest bearing accounts, money market deposit accounts, NOW accounts, time deposits, safe deposit services, credit cards, cash management, direct deposits, notary services, night depository, prepaid debit cards, cashier s checks, domestic collections, savings bonds, automated teller services, drive-in tellers, internet banking, telephone banking, and banking by mail. In addition, the Bank makes secured and unsecured commercial and real estate loans, issues stand-by letters of credit and grants available credit for installment, unsecured and secured personal loans, residential mortgages and home equity loans, as well as automobile and other types of consumer financing. The Bank provides automated teller machine (ATM) cards, as a part of the Star, NYCE, and Plus ATM networks, thereby permitting customers to utilize the convenience of larger ATM networks. The Bank also is a member of the Certificate of Deposit Account Registry Service (CDARS). CDARs can provide a customer multi-million dollar FDIC insurance on CD investments through the transfer and/or exchange with other FDIC insured institutions. CDARS is a registered service mark of Promontory Interfinancial Network, LLC.

The Bank operates a Wealth Management Services (WMS or Wealth Management) division that began with the granting of trust powers to the Bank in 1919. The WMS division provides personalized services that include investment management, trust, estate settlement, retirement, insurance, and brokerage services.

The Bank, through its subsidiary Fauquier Bank Services, Inc., has equity ownership interests in Bankers Insurance, LLC, a Virginia independent insurance company; Infinex Investments, Inc., a full service broker/dealer; and Bankers Title Shenandoah, LLC, a title insurance company. Bankers Insurance consists of a consortium of 36 Virginia

community bank owners; Infinex is owned by 54 banks and banking associations in various states; and Bankers Title Shenandoah is owned by 17 Virginia community banks. On April 30, 2008, the Bank s ownership of stock in BI Investments, LLC was exchanged for Infinex stock as part of a merger.

The revenues of the Bank are primarily derived from interest on, and fees received in connection with, real estate and other loans, and from interest and dividends from investment and mortgage-backed securities, and short-term investments. The principal sources of funds for the Bank s lending activities are its deposits, repayment of loans, the sale and maturity of investment securities, and borrowings from the Federal Home Loan Bank (FHLB) of Atlanta. Additional revenues are derived from fees for deposit-related and WMS-related services. The Bank s principal expenses are the interest paid on deposits and operating and general administrative expenses.

As is the case with banking institutions generally, the Bank s operations are materially and significantly influenced by general economic conditions and by related monetary and fiscal policies of financial institution regulatory agencies, including the Board of Governors of the Federal Reserve System (Federal Reserve). As a Virginia-chartered bank and a member of the Federal Reserve, the Bank is supervised and examined by the Federal Reserve and the Virginia State Corporation Commission. Interest rates on competing investments and general market rates of interest influence deposit flows and costs of funds. Lending activities are affected by the demand for financing of real estate and other types of loans, which in turn is affected by the interest rates at which such financing may be offered and other factors affecting local demand and availability of funds. The Bank faces strong competition in the attraction of deposits (its primary source of lendable funds) and in the origination of loans. Please see Risk Factors in Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

As of June 30, 2009, the Company had total consolidated assets of $530.8 million, total loans net of allowance for loan losses of $452.1 million, total consolidated deposits of $412.6 million, and total consolidated shareholders equity of $41.4 million.

CRITICAL ACCOUNTING POLICIES

GENERAL. The Company s financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within our statements is, to a significant extent, based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use in our estimates. In addition, GAAP itself may change from one previously acceptable accounting method to another method. Although the economics of the Company s transactions would be the same, the timing of events that would impact the Company s transactions could change.

ALLOWANCE FOR LOAN LOSSES. The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on three basic principles of accounting: (i) Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies, which requires that losses be accrued when they are probable of occurring and estimable, (ii) SFAS No. 114, Accounting by Creditors for Impairment of a Loan, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance and (iii) SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues, which requires adequate documentation to support the allowance for loan losses estimate.

The Company s allowance for loan losses has two basic components: the specific allowance and the general allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. The specific allowance is used to individually allocate an allowance for larger balance, non-homogeneous loans. The specific allowance uses various techniques to arrive at an estimate of loss. First, analysis of the borrower s overall financial condition, resources and payment record, the prospects for support from financial guarantors, and the fair market value of collateral are used to estimate the probability and severity of inherent losses. Then the migration of historical default rates and loss severities, internal risk ratings, industry and market conditions and trends, and other environmental factors are considered. The use of these values is inherently subjective and our actual losses could be greater or less than the estimates. The general allowance is used for estimating the loss on pools of smaller-balance, homogeneous loans; including 1-4 family mortgage loans, installment loans, other consumer loans, and outstanding loan commitments. Also, the general allowance is used for the remaining pool of larger balance, non-homogeneous loans which were not allocated a specific allowance upon their review. The general allowance begins with estimates of probable losses inherent in the homogeneous portfolio based upon various statistical analyses. These include analysis of historical and peer group delinquency and credit loss experience, together with analyses that reflect current trends and conditions. The Company also considers trends and changes in the volume and term of loans, changes in the credit process and/or lending policies and procedures, and an evaluation of overall credit quality. The general allowance uses a historical loss view as an indicator of future losses. As a result, even though this history is regularly updated with the most recent loss information, it could differ from the loss incurred in the future. The general allowance also captures

losses that are attributable to various

economic events, industry or geographic sectors whose impact on the portfolio have occurred but have yet to be recognized in the specific allowances.

EXECUTIVE OVERVIEW

This discussion is intended to focus on certain financial information regarding the Company and the Bank and may not contain all the information that is important to the reader. The purpose of this discussion is to provide the reader with a more thorough understanding of our financial statements. As such, this discussion should be read carefully in conjunction with the consolidated financial statements and accompanying notes contained elsewhere in this report.

The Bank is the primary independent community bank in its immediate market area as measured by deposit market share. It seeks to be the primary financial service provider for its market area by providing the right mix of consistently high quality customer service, efficient technological support, value-added products, and a strong commitment to the community. The Company and the Bank s primary operating businesses are in commercial and retail lending, deposit accounts and core deposits, and assets under WMS management.

Net income of $724,000 for the second quarter of 2009, was a 23.2% decrease from the net income for the second quarter of 2008 of $942,000. Net income of $1.65 million for the six months ending June 30, 2009, was a 15.6% decrease from the net income for the six months ending June 30, 2008 of $1.95 million. Loans, net of reserve, totaling $452.1 million at June 30, 2009, increased 4.0% when compared with December 31, 2008, and increased 6.4% when compared with June 30, 2008. Deposits, totaling $412.6 million at June 30, 2009, increased 3.1% compared with year-end 2008, and increased 6.3% when compared with June 30, 2008. Assets under WMS management, totaling $279.3 million in market value at June 30, 2009, declined 3.1% from $288.2 million in market value at June 30, 2008, due to the decline in valuations of common stock under management. For example, from June 30, 2008 to June 30, 2009, stocks measured in the Standard & Poors 500 index declined by approximately 28.5%.

Net interest income is the largest component of net income, and equals the difference between income generated on interest-earning assets and interest expense incurred on interest-bearing liabilities. Future trends regarding net interest income are dependent on the absolute level of market interest rates, the shape of the yield curve, the amount of lost income from non-performing assets, the amount of prepaying loans, the mix and amount of various deposit types, competition for loans and deposits, and many other factors, as well as the overall volume of interest-earning assets. These factors are individually difficult to predict, and when taken together, the uncertainty of future trends compounds. Based on management s current projections, net interest income may increase in 2009 and beyond as average interest-earning assets increase, but this may be offset in part or in whole by a possible contraction in the Bank s net interest margin resulting from competitive market conditions and/or a flat or inverted yield curve. A steeper yield curve is projected to result in an increase in net interest income, while a flatter or inverted yield curve is projected to result in a decrease in net interest income.

Since the third quarter of 2008, the Bank has seen its competition for deposits increase significantly. The pricing of retail deposits, which traditionally has been at an interest rate less than the interest rate on a FHLB of Atlanta advance of similar term, has exceeded the corresponding FHLB rate by 50 to 100 basis points or more. The increased cost of deposits has resulted in less net interest income and a narrower net interest margin. The intensified competition for deposits is, for the most part, the result of liquidity and capitalization pressures faced by many of the large multi-state financial institutions who compete in the Bank s market area.

The Bank s non-performing assets totaled $3.2 million or 0.70% of total loans and repossessed assets, including real estate owned, at June 30, 2009, as compared with $4.3 million or 0.97% of total loans and repossessed assets at December 31, 2008, and $3.0 million or 0.70% of total loans and repossessed assets at June 30, 2008. The provision for loan losses was $560,000 for the first six months of 2009 compared with $1.29 million for the first six months of 2008. Loan chargeoffs, net of recoveries, totaled $249,000 or 0.06% of total average loans for the first six months of 2009, compared with $1.16 million or 0.28% of total average loans for the first six months of 2008. The $730,000 decrease in the provision for loan losses from the first six months of 2008 to the first six months of 2009 was largely in response to the $907,000 decline in net charge-offs for the respective six month periods, as well as the decline in non-performing assets since September 30, 2008. Total allowance for loan losses was $5.1 million or 1.11% of total

loans at June 30, 2009 compared with $4.8 million or 1.08% of loans at December 31, 2008 and $4.3 million or 1.02% of loans at June 30, 2008.

Management seeks to continue the expansion of its branch network. The Bank has leased properties in Bristow, Virginia and Haymarket, Virginia, in order to build its ninth and tenth full-service branch offices, respectively. The Bristow office opened on July 13, 2009, and the Haymarket office is scheduled to open in late 2009 or early 2010. The Bank is looking toward these new retail markets for growth in deposits and WMS income. Management seeks to increase the level of its fee income from deposits and WMS through the increase of its market share within its marketplace.

COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS ENDED JUNE 30, 2009 AND JUNE 30, 2008

NET INCOME

Net income was $724,000 for the second quarter of 2009, a 23.2% decrease from the second quarter of 2008 net income of $942,000. Earnings per share on a fully diluted basis were $0.20 in 2009 compared to $0.26 in 2008. Profitability as measured by return on average assets decreased from 0.76% in the second quarter of 2008 to 0.55% for the same period in 2009. Profitability as measured by return on average equity decreased from 8.80% to 7.02% over the same respective second quarters in 2008 and 2009. The decline in net income and the corresponding profitability measures was primarily due to the increase of $374,000 in FDIC insurance including a $240,000 special assessment at June 30, 2009, expenses of approximately $291,000 related to the contested election of directors at the 2009 annual meeting of shareholders (proxy contest), and the $113,000 loss on the impairment of the Company s investment in Silverton Bank s common stock. This was partially offset by a $299,000 increase in net interest income in the second quarter of 2009 compared with the second quarter of 2008, and a $474,000 reduction in provision for loan losses for the same time periods. The impact of the proxy contest on net income was approximately $192,000, net of tax benefit, or $0.053 per share on a fully diluted basis for the quarter. The impact of the $240,000 FDIC special assessment was approximately $158,000, net of tax benefit, or $0.044 per share on a fully diluted basis for the quarter. The impact of the $113,000 loss on the impairment of the investment in Silverton Bank s common stock, having no corresponding tax benefit at this time, had the impact of approximately $0.031 per share on a fully diluted basis for the quarter.

The following table reconciles various non-GAAP adjustments to net income on a GAAP basis.

	(Dollars in Thousands)			
	Before Taxes	Tax Expense	After Taxes	Per Fully-Diluted Share
For the Quarter Ended June 30, 2009				
Net income on GAAP basis	$ 996	$ 272	$ 724	$ 0.201
Plus: Proxy contest expense	291	99	192	0.053
Plus: FDIC special assessment expense	240	82	158	0.044
Plus: Impairment loss on Silverton stock	113	0	113	0.031
Net income after non-GAAP adjustment items	$1,640	$ 453	$1,187	$ 0.329

Tax expense is computed using a federal tax rate of 34%, except for the loss on impairment of Silverton stock, which has no tax benefit at this time.

For Quarter ended

	June 30, 2009
Return on Average Assets:	
Net income on GAAP basis	0.55%
Net income after non-GAAP adjustment items	0.90%

	For Quarter ended June 30, 2009
Return on Average Equity:	
Net income on GAAP basis	7.02%
Net income after non-GAAP adjustment items	11.52%

NET INTEREST INCOME AND EXPENSE

Net interest income increased $299,000 or 6.2% to $5.17 million for the quarter ended June 30, 2009 from $4.87 million for the quarter ended June 30, 2008. The increase in net interest income was partially due to the impact of total average earning assets increasing 6.0% from $462.4 million during the second quarter of 2008 to $490.3 million during the second quarter of 2009. In addition, the Company s net interest margin increased from 4.22% in the second quarter of 2008 to 4.23% in the second quarter of 2009.

Total interest income decreased $182,000 or 2.6% to $6.88 million for the second quarter of 2009 from $7.06 million for the second quarter of 2008. This decrease was primarily due to the 47 basis point decrease in the yield on average assets from second quarter 2008 to second quarter 2009. This was partially offset by the increase in total average earning assets of $27.9 million.

The average yield on loans decreased to 5.76% for the second quarter of 2009 compared with 6.23% for the second quarter of 2008. Average loan balances increased $26.8 million or 6.4% from $422.5 million during the second quarter of 2008 to $449.3 million during the second quarter of 2009. The decline in rate, partially offset by the increase in loans outstanding, resulted in a $104,000 or 1.6% decrease in interest and fee income from loans for the second quarter of 2009 compared with the same period in 2008.

Average investment security balances decreased $4.0 million from $38.6 million in the second quarter of 2008 to $34.6 million in the second quarter of 2009. The tax-equivalent average yield on investments decreased from 5.11% for the second quarter of 2008 to 4.82% for the second quarter of 2009. Together, there was a decrease in interest and dividend income on security investments of $73,000 or 15.8%, from $462,000 for the second quarter of 2008 to $390,000 for the second quarter of 2009. This decrease was primarily due to the suspension of dividend income on FHLB of Atlanta stock for the second quarter of 2009. Interest income on deposits in other banks decreased $1,000 from second quarter 2008 to second quarter 2009. Interest income on federal funds sold decreased $4,000 from the second quarter of 2008 to the second quarter of 2009, reflecting a decline in the average balances from $549,000 to $75,000.

Total interest expense decreased $482,000 or 22.0% from $2.19 million for the second quarter of 2008 to $1.71 million for the second quarter of 2009 primarily due to the overall decline in shorter-term market interest rates. Interest paid on deposits decreased $209,000 or 12.6% from $1.65 million for the second quarter of 2008 to $1.44 million for the second quarter of 2009. Average NOW deposit balances decreased $12.3 million from the second quarter of 2008 to the second quarter of 2009, while the average rate on NOW accounts decreased from 0.89% to 0.40% resulting in a reduction of $122,000 in NOW interest expense for the second quarter of 2009. Average money market account balances decreased $23.5 million from second quarter 2008 to second quarter 2009, while their average rate decreased from 1.94% to 0.79% over the same period resulting in a decrease of $315,000 of interest expense for the second quarter of 2009. Average time deposit balances increased $63.0 million from second quarter of 2008 to the second quarter of 2009 while the average rate on time deposits decreased from 3.66% to 2.86% resulting in an increase of $243,000 in interest expense for the second quarter of 2009.

Interest expense on federal funds purchased decreased $17,000 for the second quarter of 2009 when compared to the second quarter of 2008 due to the decline in the average fed funds rate from 2.45% to 1.28%, as well as the $1.0 million decrease in average federal funds purchased. Interest expense on FHLB of Atlanta advances decreased $240,000 from the second quarter of 2008 to the second quarter of 2009 due to the decrease in the average rate paid on FHLB advances from 3.51% to 1.61%, partially offset by the increase in average FHLB advance balances of $3.6 million, The average rate on total interest-bearing liabilities decreased from 2.29% for the second quarter of 2008 to 1.65% for the second quarter of 2009.

The following table sets forth information relating to the Company s average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated and the average yields and rates paid for the

periods indicated. These yields and costs are derived by dividing income or expense by the average daily balances of assets and liabilities, respectively, for the periods presented.

AVERAGE BALANCES, INCOME AND EXPENSES, AND AVERAGE YIELDS AND RATES
(Dollars in Thousands)

	Three Months Ended June 30, 2009			Three Months Ended June 30, 2008		
	Average Balances	Income/ Expense	Average Rate	Average Balances	Income/ Expense	Average Rate
ASSETS:						
Loans						
Taxable	$ 439,302	$ 6,390	5.76%	$ 412,973	$ 6,498	6.24%
Tax-exempt (1)	8,450	146	6.84%	7,752	141	7.16%
Nonaccrual (2)	1,574			1,758		
Total Loans	449,326	6,536	5.76%	422,483	6,639	6.23%
Securities						
Taxable	29,187	329	4.51%	33,127	404	4.88%
Tax-exempt (1)	5,365	88	6.54%	5,446	88	6.47%
Total securities	34,552	417	4.82%	38,573	492	5.11%
Deposits in banks	6,397	3	0.20%	811	4	2.19%
Federal funds sold	75	0.1	0.25%	549	4	3.21%
Total earning assets	490,350	6,956	5.62%	462,416	7,139	6.13%
Less: Reserve for loan losses	(5,013)			(4,196)		
Cash and due from banks	6,823			16,521		
Bank premises and equipment, net	9,685			8,561		
Other assets	21,633			16,587		
Total Assets	$ 523,478			$ 499,889		
LIABILITIES & SHAREHOLDERS EQUITY:						
Deposits						
Demand deposits	$ 63,575			$ 69,981		
Interest-bearing deposits						
NOW accounts	77,702	78	0.40%	89,958	200	0.89%
Money market accounts	70,406	138	0.79%	93,866	453	1.94%
Savings accounts	34,579	24	0.27%	31,893	38	0.47%

Time deposits	168,509	1,201	2.86%	105,466	959	3.66%
Total interest-bearing deposits	351,196	1,441	1.65%	321,183	1,650	2.07%
Federal funds purchased	3,900	12	1.28%	4,910	30	2.45%
Federal Home Loan Bank advances	56,464	230	1.61%	52,912	469	3.51%
Capital securities of subsidiary trust	4,124	29	2.82%	4,124	45	4.36%
Total interest-bearing liabilities	415,684	1,712	1.65%	383,129	2,194	2.29%
Other liabilities	2,875			3,700		
Shareholders equity	41,344			43,079		
Total Liabilities & Shareholders Equity	$ 523,478			$ 499,889		
Net interest spread		$ 5,244	3.98%		$ 4,945	3.83%
Interest expense as a percent of average earning assets			1.40%			1.91%
Net interest margin			4.23%			4.22%

(1) Income and rates on non-taxable assets are computed on a tax equivalent basis using a federal tax rate of 34%.

(2) Nonaccrual loans are included in the average balance of total loans and total earning assets.

RATE/VOLUME ANALYSIS

The following table sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to changes in volume (change in volume multiplied by old rate); and changes in rates (change in rate multiplied by old volume). Changes in rate-volume, which cannot be separately identified, are allocated proportionately between changes in rate and changes in volume.

RATE / VOLUME VARIANCE
(In Thousands)
Three Months Ended June 30, 2009 Compared to
Three Months Ended June 30, 2008

	Change	Due to Volume	Due to Rate
INTEREST INCOME			
Loans; taxable	$ (108)	$ 414	(522)
Loans; tax-exempt (1)	5	13	(8)
Securities; taxable	(75)	(48)	(27)
Securities; tax-exempt (1)		(1)	1
Deposits in banks	(1)	28	(29)
Federal funds sold	(4)	(3)	(1)
Total Interest Income	(183)	403	(586)
INTEREST EXPENSE			
NOW accounts	(122)	(27)	(95)
Money market accounts	(315)	(113)	(202)
Savings accounts	(14)	3	(17)
Time deposits	243	573	(330)
Federal funds purchased and securities sold under agreements to repurchase	(18)	(6)	(12)
Federal Home Loan Bank advances	(239)	31	(270)
Capital securities of subsidiary trust	(16)		(16)
Total Interest Expense	(481)	461	(942)
Net Interest Income	$ 298	$ (58)	$ 356

(1) Income and rates on non-taxable assets are computed on a tax equivalent basis using a federal tax rate of 34%.

PROVISION FOR LOAN LOSSES, ALLOWANCE FOR LOAN LOSSES, AND ASSET QUALITY

The provision for loan losses was $360,000 for the second quarter of 2009, compared with $834,000 for the second quarter of 2008. The amount of the provision for loan loss was based upon management s continual evaluation of the adequacy of the allowance for loan losses, which encompasses the overall risk characteristics of the loan portfolio, trends in the Bank s delinquent and non-performing loans, estimated values of collateral, and the impact of economic conditions on borrowers. Greater weight is given to the loss history by loan category, prolonged changes in portfolio delinquency trends by loan category, and changes in economic trends. There can be no assurances, however, that future losses will not exceed estimated amounts, or that increased amounts of provisions for loan losses will not be required in future periods.

The $474,000 decrease in the provision for loan losses during the second quarter of 2009, compared to the same quarter one year earlier, was largely in response to the decline in loan charge-offs during the quarter ended June 30, 2009 compared to the previous year, and the decline in non-performing assets since September 30, 2008.

OTHER INCOME

Total other income decreased by $439,000 from $1.65 million for the second quarter of 2008 to $1.21 million in the second quarter of 2009. Non-interest income is derived primarily from non-interest fee income, which consists primarily of fiduciary and other Wealth Management fees, service charges on deposit accounts, and other fee income. The decrease in other income primarily reflects the loss on impairment of the Company s investment in

Silverton Bank s common stock and in pooled trust preferred securities of $113,000 and $53,000, respectively, as well as declines in Wealth Management income and service charges on deposit accounts. In addition, during the second quarter of 2008, the Bank recognized a $217,000 gain due to the Bank s ownership interest in Infinex, a full service broker/dealer. On April 30, 2008, Infinex merged with Bankers Investment Group, LLC. As part of the merger, equity was infused by the new participants, which in turn, recapitalized the Bank s existing ownership position. There was no similar activity during the second quarter of 2009.

Wealth Management income decreased $86,000 or 26.0% from the second quarter of 2008 to the second quarter of 2009, as assets under management declined from year to year, primarily due to the decline in overall stock market valuations. During the remainder of 2009, Wealth Management fees are projected to grow at a pace closer to the 3% to 5% growth seen in 2007, rather than the 26% decline seen in the second quarter of 2009 or the 9% decline in 2008, but further growth or decline in Wealth Management fees is significantly dependent on the growth or decline in value of the U.S. and international stock and bond markets.

Service charges on deposit accounts decreased $32,000 or 4.3% to $719,000 for the three months ending June 30, 2009 compared to one year earlier. Due to changes in economic conditions and consumer confidence, it appears that customer s usage of various deposit services has significantly lessened. Whether this is a temporary cyclical change, or a more permanent structural change is difficult to determine at this point in time.

Other service charges, commissions and fees decreased $249,000 or 37.6% from $664,000 in second quarter 2008 to $414,000 in second quarter 2009. During the second quarter of 2008, the Bank recognized a $217,000 gain due to the Bank s ownership interest in Infinex, a full service broker/dealer. There was no corresponding gain during the second quarter of 2009. Also included in other service charges, commissions, and income is Bank Owned Life Insurance (BOLI) income, which was $102,000 during the second quarter of 2009 compared with $94,000 for the same quarter one year earlier. Total BOLI was $10.6 million at June 30, 2009, compared with $10.2 million one year earlier.

OTHER EXPENSE

Total other expense increased $628,000 or 14.3% during the second quarter of 2009 compared with the second quarter of 2008. The entire increase is due to the additional legal and shareholder relations expense of $291,000 associated with the proxy contest at the 2009 annual meeting, and the $374,000 increase in FDIC insurance expense from second quarter 2008 to second quarter 2009.

Salaries and employees benefits increased $32,000 or 1.4%, primarily due to the year-to-year increase in the total number of staff, as well as pension expense associated with the defined benefit pension plan scheduled to be terminated at December 31, 2009. Active full-time equivalent personnel totaled 156 at June 30, 2009 compared with 145 at June 30, 2008. The June 2009 data includes seven full-time equivalent positions being trained to staff the Bristow branch office scheduled to open in July 2009.

On December 20, 2007, the Company s Board of Directors (Board) approved the termination of the defined benefit pension plan effective on December 31, 2009, and effective January 1, 2010 the Board approved to replace the defined benefit pension plan with an enhanced 401(k) plan. Defined benefit pension plan expenses are projected to be approximately $285,000 in 2009, and nothing due to curtailment going forward. Expenses for the 401(k) plan are projected to increase from approximately $154,000 in 2009 to approximately $625,000 in 2010. Growth in 401(k) after 2010 is projected to increase approximately at the same rate of increase as salaries.

The Bank expects personnel costs, consisting primarily of salary and benefits, to continue to be its largest other expense. As such, the most important factor with regard to potential changes in other expenses is the expansion of staff. The cost of any additional staff expansion, however, would be expected to be offset by the increased revenue generated by the additional services that the new staff would enable the Bank to perform. For the remainder of 2009, the Company projects no additional increase of new full-time equivalent positions unless the Haymarket office opens in December 2009. In late 2009 or, early 2010, the Company will increase full-time equivalent personnel in order to staff the branch office in Haymarket.

Net occupancy expense decreased $30,000 or 8.5%, and furniture and equipment expense decreased $16,000 or 5.7%, from second quarter 2008 to second quarter 2009 due to increased expense control by all Bank associates.
Marketing expense increased $32,000 or 20.2% from $156,000 for the second quarter of 2008 to $187,000 for the second quarter of 2009. This increase primarily reflects the marketing campaigns associated with the new Bristow branch opening in July 2009. Marketing expenses for all of 2009 are projected to be approximately the same as 2008.
Consulting expense, which includes legal and accounting professional fees, increased $216,000 or 82.9% in the second quarter of 2009 compared with the second quarter of 2008. This increase primarily reflects increased legal fees associated with the 2009 annual meeting of shareholders and the contested election of directors related to the meeting, which added an approximate $180,000 to legal expense.
Data processing expense decreased $4,000 or 1.2% for the second quarter of 2009 compared with the same time period in 2008. The Bank outsources much of its data processing to a third-party vendor.
Other operating expenses increased $398,000 or 55.5% in the second quarter of 2009 compared with the second quarter of 2008. The increase in expense primarily reflects an increase in FDIC deposit insurance expense from $11,000 for the second quarter of 2008 to $385,000 for the second quarter of 2009 which includes approximately $240,000 for the FDIC s special assessment. FDIC expense is projected to increase from $291,000 for all of 2008 to approximately $820,000 for 2009, taking into consideration the $240,000 special assessment expense required by the FDIC at June 30, 2009. In addition, the contested election of directors added an approximate $95,000 to other operating expenses for the second quarter of 2009.

INCOME TAXES

Income tax expense was $272,000 for the quarter ended June 30, 2009 compared with $346,000 for the quarter ended June 30, 2008. The effective tax rates were 27.3% and 26.9% for the second quarter of 2009 and 2008, respectively. The effective tax rate differs from the statutory federal income tax rate of 34% due to the Bank s investment in tax-exempt loans and securities, and income from the BOLI purchases.

COMPARISON OF OPERATING RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND JUNE 30, 2008

NET INCOME

Net income was $1.65 million for the first six months of 2009, a 15.6% decrease from the first six months of 2008 net income of $1.95 million. Earnings per share on a fully diluted basis were $0.46 in 2009 compared to $0.55 in 2008. Profitability as measured by return on average assets decreased from 0.79% in the first six months of 2008 to 0.64% for the same period in 2009. Profitability as measured by return on average equity decreased from 9.14% to 7.94% over the same respective six month periods in 2008 and 2009. The decline in net income and the corresponding profitability measures was primarily due to the loss on the sale of other real estate owned totaling $136,000, the loss on impairment of the Company s investment in Silverton Bank common stock totaling $113,000, the expenses associated with the contested election of directors at the 2009 annual meeting of shareholders totaling approximately $291,000, and the increase in FDIC insurance of $507,000. These were partially offset by a $524,000 increase in net interest income in the first six months of 2009 compared with the first six months of 2008.

The following table reconciles various non-GAAP adjustments to net income on a GAAP basis.

	(Dollars in Thousands)			
	Before Taxes	Tax Expense	After Taxes	Per Fully-Diluted Share
For the Six Months Ended June 30, 2009				
Net income on GAAP basis	$2,260	$ 613	$1,647	$ 0.458
Plus: Proxy contest expense	291	99	192	0.053
Plus: FDIC special assessment expense	240	82	158	0.044
Plus: Impairment loss on Silverton stock	113	0	113	0.031
Net income after non-GAAP adjustment items	$2,904	$ 794	$2,110	$ 0.586

Tax expense is computed using a federal tax rate of 34%, except for the loss on impairment of Silverton stock, which has no tax benefit at this time.

	For Six Months ended June 30, 2009
Return on Average Assets:	
Net income on GAAP basis	0.64%
Net income after non-GAAP adjustment items	0.82%
Return on Average Equity:	
Net income on GAAP basis	7.94%
Net income after non-GAAP adjustment items	10.17%

NET INTEREST INCOME AND EXPENSE

Net interest income increased $524,000 or 5.5% to $10.08 million for the six months ended June 30, 2009 from $9.56 million for the six months ended June 30, 2008. The increase in net interest income was due to the impact of total average earning assets increasing 6.6% from $457.8 million during the first six months of 2008 to $488.0 million during the first six months of 2009. This was partially offset by the Company s net interest margin decreasing from 4.18% in the first six months of 2008 to 4.17% in the first six months of 2009.

Total interest income decreased $671,000 or 4.7% to $13.67 million for the first six months of 2009 from $14.34 million for the first six months of 2008. This decrease was primarily due to the 64 basis point decrease in the yield on average assets from the first six months 2008 to the first six months 2009. This was partially offset by the increase in total average earning assets of $30.2 million.

The average yield on loans decreased to 5.78% for the first six months of 2009 compared with 6.41% for the first six months of 2008. Average loan balances increased $29.7 million or 7.1% from $416.5 million during the first six months of 2008 to $446.3 million during the first six months of 2009. The decline in rate, partially offset by the increase in loans outstanding, resulted in a $542,000 or 4.1% decrease in interest and fee income from loans for the first six months of 2009 compared with the same period in 2008.

Average investment security balances decreased $1.8 million from $38.0 million in the first six months of 2008 to $36.1 million in the first six months of 2009. The tax-equivalent average yield on investments decreased from 5.06% for the first six months of 2008 to 4.83% for the first six months of 2009. Together, there was a decrease in interest

and dividend income on security investments of $89,000 or 9.9%, from $901,000 for the first six months of 2008 to $812,000 for the first six months of 2009. This decrease was primarily due to the suspension of dividend income on FHLB of Atlanta stock during the first six months of 2009, as well as the decline in average balances on securities. Interest income on deposits in other banks decreased $6,000 from first six months of 2008 to first six

months of 2009. Interest income on federal funds sold decreased $33,000 from the first six months of 2008 to the first six months of 2009, reflecting a decline in the average balances from $2.5 million to $122,000.

Total interest expense decreased $1.19 million or 25.0% from $4.78 million for the first six months of 2008 to $3.58 million for the first six months of 2009 primarily due to the overall decline in shorter-term market interest rates. Interest paid on deposits decreased $724,000 or 19.4% from $3.72 million for the first six months of 2008 to $3.00 million for the first six months of 2009. Average NOW deposit balances decreased $10.8 million from the first six months of 2008 to the first six months of 2009, while the average rate on NOW accounts decreased from 1.08% to 0.42% resulting in a reduction of $311,000 in NOW interest expense for the first six months of 2009. Average money market account balances decreased $25.7 million from the first six months 2008 to the first six months 2009, while their average rate decreased from 2.26% to 0.88% over the same period resulting in a decrease of $773,000 of interest expense for the first six months of 2009. Average time deposit balances increased $56.5 million from the first six months of 2008 to the first six months of 2009 while the average rate on time deposits decreased from 3.91% to 3.04% resulting in an increase of $385,000 in interest expense for the first six months of 2009.

Interest expense on federal funds purchased decreased $41,000 for the first six months of 2009 when compared to the first six months of 2008 due to the decline in the average fed funds rate from 3.19% to 1.32%, and the $511,000 decrease in average federal funds purchased. Interest expense on FHLB of Atlanta advances decreased $385,000 from the first six months of 2008 to the first six months of 2009 due to the decrease in the average rate paid on FHLB advances from 3.73% to 1.72%, partially offset by the increase in average FHLB advance balances of $10.0 million. The expense on the distribution on capital securities of subsidiary trusts decreased $44,000 for the first six months of 2009 when compared to the first six months of 2008 due to the decline in their three-month LIBOR-indexed interest rate from 5.35% to 3.15%.

The average rate on total interest-bearing liabilities decreased from 2.53% for the first six months of 2008 to 1.76% for the first six months of 2009.

The following table sets forth information relating to the Company s average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated and the average yields and rates paid for the periods indicated. These yields and costs are derived by dividing income or expense by the average daily balances of assets and liabilities, respectively, for the periods presented.

AVERAGE BALANCES, INCOME AND EXPENSES, AND AVERAGE YIELDS AND RATES
(Dollars in Thousands)

	Six Months Ended June 30, 2009			**Six Months Ended June 30, 2008**		
	Average Balances	**Income/ Expense**	**Average Rate**	**Average Balances**	**Income/ Expense**	**Average Rate**
ASSETS:						
Loans						
Taxable	$ 436,220	$ 12,654	5.78%	$ 407,443	$ 13,209	6.41%
Tax-exempt (1)	8,492	291	6.82%	7,549	273	7.16%
Nonaccrual (2)	1,552			1,537		
Total Loans	446,264	12,945	5.78%	416,529	13,482	6.42%
Securities						
Taxable	30,606	692	4.52%	32,526	785	4.63%
Tax-exempt (1)	5,518	181	6.56%	5,447	176	6.48%
Total securities	36,124	873	4.83%	37,973	961	5.06%
Deposits in banks	5,533	7	0.25%	897	13	2.77%
Federal funds sold	122	0.2	0.26%	2,469	33	2.71%
Total earning assets	488,043	13,825	5.64%	457,868	14,489	6.28%
Less: Reserve for loan losses	(4,948)			(4,181)		
Cash and due from banks	9,148			16,016		
Bank premises and equipment, net	9,218			8,013		
Other assets	20,333			16,503		
Total Assets	$ 521,794			$ 494,219		
LIABILITIES & SHAREHOLDERS EQUITY:						
Deposits						
Demand deposits	$ 63,869			$ 68,348		
Interest-bearing deposits						

NOW accounts	76,982	159	0.42%	87,778	470	1.08%
Money market accounts	70,813	311	0.88%	96,520	1,084	2.26%
Savings accounts	33,001	48	0.30%	31,168	72	0.46%
Time deposits	164,586	2,482	3.04%	108,130	2,098	3.91%
Total interest-bearing deposits	345,382	3,000	1.75%	323,596	3,724	2.31%
Federal funds purchased	3,488	23	1.32%	3,999	63	3.19%
Federal Home Loan Bank advances	57,480	496	1.72%	47,465	881	3.73%
Capital securities of subsidiary trust	4,124	65	3.15%	4,124	110	5.35%
Total interest-bearing liabilities	410,474	3,584	1.76%	379,184	4,778	2.53%
Other liabilities	5,631			3,757		
Shareholders equity	41,820			42,930		
Total Liabilities & Shareholders Equity	$ 521,794			$ 494,219		
Net interest spread		$ 10,241	3.89%		$ 9,711	3.75%
Interest expense as a percent of average earning assets			1.48%			2.10%
Net interest margin			4.17%			4.18%

(1) Income and rates on non-taxable assets are computed on a tax equivalent basis using a federal tax rate of 34%.

(2) Nonaccrual loans are included in the average balance of total loans and total earning assets.

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RATE/VOLUME ANALYSIS

The following table sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to changes in volume (change in volume multiplied by old rate); and changes in rates (change in rate multiplied by old volume). Changes in rate-volume, which cannot be separately identified, are allocated proportionately between changes in rate and changes in volume.

RATE / VOLUME VARIANCE
(In Thousands)
Six Months Ended June 30, 2009 Compared to
Six Months Ended June 30, 2008

	Change	Due to Volume	Due to Rate
INTEREST INCOME			
Loans; taxable	$ (555)	$ 933	(1,488)
Loans; tax-exempt (1)	18	34	(16)
Securities; taxable	(93)	(46)	(47)
Securities; tax-exempt (1)	5	2	3
Deposits in banks	(6)	67	(73)
Federal funds sold	(33)	(31)	(2)
Total Interest Income	(664)	959	(1,623)
INTEREST EXPENSE			
NOW accounts	(311)	(58)	(253)
Money market accounts	(773)	(289)	(484)
Savings accounts	(24)	4	(28)
Time deposits	385	1,095	(710)
Federal funds purchased and securities sold under agreements to repurchase	(40)	(8)	(32)
Federal Home Loan Bank advances	(385)	186	(571)
Capital securities of subsidiary trust	(45)		(45)
Total Interest Expense	(1,193)	930	(2,123)
Net Interest Income	$ 529	$ 29	$ 500

(1) Income and rates on non-taxable assets are computed on a tax equivalent basis using a federal tax rate of 34%.

PROVISION FOR LOAN LOSSES, ALLOWANCE FOR LOAN LOSSES, AND ASSET QUALITY

The provision for loan losses was $560,000 for the first six months of 2009, compared with $1.29 million for the first six months of 2008.

The $730,000 decrease in the provision for loan losses during the first six months of 2009, compared to the same period one year earlier, was largely in response to the decline in loan charge-offs during the six months ended June 30, 2009 and the decline in non-performing assets since September 30, 2008.

OTHER INCOME

Total other income decreased by $862,000 from $3.22 million for the first six months of 2008 to $2.36 million in the first six months of 2009. The decrease in other income primarily reflects the loss on the impairment of securities totaling $166,000, and the loss on sale of other real estate owned properties of $136,000, as well as declines in Wealth Management income and service charges on deposit accounts. In addition, there was the recognition of a $217,000 gain due to the Bank s ownership interest in Infinex, and an $88,000 gain on sale of investments during the first six months of 2008 that did not reoccur in 2009.

Wealth Management income decreased $178,000 or 26.4% from the first six months of 2008 to the first six months of 2009, as assets under management declined from year to year, primarily due to the decline in overall stock market valuations.

Service charges on deposit accounts decreased $134,000 or 9.2% to $1.33 million for the first six months of 2009 compared to the same period one year earlier.

Other service charges, commissions and fees decreased $257,000 or 23.5% from $1.09 million in the first six months 2008 to $836,000 in the first six months 2009. This decrease was primarily due to the recognition of a $217,000 gain due to the Bank s ownership interest in Infinex in 2008. Also included in other service charges, commissions, and income is BOLI income, which was $202,000 during the first six months of 2009 compared with $188,000 for the same period one year earlier.

OTHER EXPENSE

Total other expense increased $827,000 or 9.4% during the first six months of 2009 compared with the first six months of 2008. The reasons for the increase are primarily the expenses related to the proxy contest totaling $291,000, and a $507,000 increase in FDIC deposit insurance expense.

Salaries and employees benefits increased $59,000 or 1.3%, primarily due to an increase in staff and pension expense associated with the termination of the defined benefit pension plan at December 31, 2009.

Net occupancy expense decreased $5,000 or 0.8%, and furniture and equipment expense decreased $22,000 or 3.9%, from the first six months 2008 to the first six months 2009.

Marketing expense decreased $17,000 or 5.3% from $325,000 for the first six months of 2008 to $308,000 for the first six months of 2009. This reduction primarily reflects timing differences of direct mail campaigns targeting both individual households and small businesses.

Consulting expense, which includes legal and accounting professional fees, increased $272,000 or 50.2% in the first six months of 2009 compared with the first six months of 2008. This increase primarily reflects increased legal fees associated legal and other consulting fees related to the 2009 annual meeting of shareholders and a contested election of directors related to the meeting.

Data processing expense increased $12,000 or 1.7% for the first six months of 2009 compared with the same time period in 2008.

Other operating expenses increased $530,000 or 37.0% in the first six months of 2009 compared with the first six months of 2008. The increase in expense primarily reflects an increase in FDIC deposit insurance expense from $23,000 for the first six months of 2008 to $530,000 for the first six months of 2009, which includes approximately $240,000 for the FDIC s special assessment. In addition, it includes other expenses related to the 2009 annual meeting of shareholders and a contested election of directors related to the meeting.

INCOME TAXES

Income tax expense was $614,000 for the six months ended June 30, 2009 compared with $745,000 for the six months ended June 30, 2008. The effective tax rates were 27.1% and 27.6% for the first six months of 2009 and 2008, respectively.

COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2009 AND DECEMBER 31, 2008

Total assets were $530.8 million at June 30, 2009 compared with $514.5 million at December 31, 2008, an increase of 3.1% or $16.3 million. Balance sheet categories reflecting significant changes included interest-bearing deposits in other banks, total loans, other real estate owned, deposits, federal funds purchased, FHLB advances, and company-obligated mandatorily redeemable capital securities. Each of these categories is discussed below.

INTEREST-BEARING DEPOSITS IN OTHER BANKS. Interest-bearing deposits in other banks were $4.4 million at June 30, 2009, reflecting an increase of $1.1 million from December 31, 2008. The increase in interest-bearing deposits in other banks was primarily due to the increase in cash held at the Federal Reserve. The higher balance at June 30, 2009 was in order to satisfy reserve requirements.

LOANS. Total net loan balance after allowance for loan losses was $452.1 million at June 30, 2009, which represents an increase of $17.5 million or 4.0% from $434.7 million at December 31, 2008. The Bank continually modifies its loan pricing strategies and expands its loan product offerings in an effort to increase lending activity without sacrificing the existing credit quality standards.

BANK PREMISES AND EQUIPMENT, NET. Bank premises and equipment increased $2.4 million from December 31, 2008 to June 30, 2009 due to the capitalization of construction costs associated with the building of new Bristow and View Tree, Warrenton branch offices.

OTHER REAL ESTATE OWNED. Other real estate owned declined by $1.0 million from December 31, 2008 to June 30, 2009 due to the sale of one property at a loss of $136,000 during the first quarter of 2009. The loss was reflected in the consolidated statement of income for the six months ended June 30, 2009.

DEPOSITS. For the six months ended June 30, 2009, total deposits increased by $12.3 million or 3.1% when compared with total deposits at December 31, 2008. Non-interest-bearing deposits decreased by $11.3 million and interest-bearing deposits increased by $23.6 million. Included in interest-bearing deposits at June 30, 2009 and December 31, 2008 were $46.6 million and $37.4 million, respectively of brokered deposits as defined by the Federal Reserve. Of the $46.6 million in brokered deposits, $31.4 million represent deposits of Bank customers, exchanged through the CDAR s network. With the CDAR s program, funds are placed into certificate of deposits issued by other banks in the network, in increments of less than $250,000, to ensure both principal and interest are eligible for complete FDIC coverage. These deposits are exchanged with other member banks on a dollar-for-dollar basis, bringing the full amount of our customers deposits back to the Bank and making these funds fully available for lending in our community. The decline in the Bank s non-interest-bearing deposits and the increase in interest-bearing deposits during the first six months of 2009 were the result of many factors difficult to segregate and quantify, and equally difficult to use as factors for future projections. The economy, local competition, retail customer preferences, changes in seasonal cash flows by both commercial and retail customers, changes in business cash management practices by Bank customers, the relative pricing from wholesale funding sources, and the Bank s funding needs all contributed to the change in deposit balances. The Bank projects to increase its transaction accounts and other deposits in 2009 and beyond through the expansion of its branch network, as well as by offering value-added NOW and demand deposit products, and selective rate premiums on its interest-bearing deposits.

FEDERAL FUNDS PURCHASED. Federal funds purchased increased by $3.5 million from December 31, 2008 to June 30, 2009 in order to partially fund the Bank s loan growth.

COMPANY-OBLIGATED MANDATORILY REDEEMABLE CAPITAL SECURITIES OF SUBSIDIARY TRUST (capital securities). On September 21, 2006, the Company established a subsidiary trust that issued $4.0 million of capital securities as part of a pooled trust preferred security offering with other financial institutions. Simultaneously, the trust used the proceeds of that offering to purchase $4.0 million principal amount of the Company s Floating Rate Junior Subordinated Deferrable Interest Debentures due 2036. Both the capital securities and the subordinated debentures are callable at any time after five years from the issue date. The subordinated debentures are an unsecured obligation of the Company and are junior in right of payment to all present and future senior indebtedness of the Company. The capital securities are guaranteed by the Company on a subordinated basis. Under applicable regulatory guidelines, the capital securities are treated as Tier 1 capital for purposes of the Federal Reserve s capital guidelines for bank holding companies, as long as the capital securities and all other cumulative preferred securities of the Company together do not exceed 25% of Tier 1 capital.

ASSET QUALITY

Non-performing assets, in most cases, consist of loans that are 90 days or more past due and for which the accrual of interest has been discontinued. Management evaluates all loans that are 90 days or more past due, as well as borrowers that have suffered financial distress, to determine if they should be placed on non-accrual status. Factors considered by management include the net realizable value of collateral, if any, and other resources of the borrower that may be available to satisfy the delinquency.

Loans are placed on non-accrual status when they have been specifically determined to be impaired or when principal or interest is delinquent for 90 days or more, unless the loans are well secured and in the process of collection. Any unpaid interest previously accrued on such loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other non-accrual loans is recognized only to the extent of interest payments received.

Non-performing assets totaled $3.2 million or 0.70% of total loans and repossessed assets at June 30, 2009, compared with $4.3 million or 0.97% of total loans and repossessed assets at December 31, 2008, and $3.0 million or 0.70% of total loans and repossessed assets at June 30, 2008.

Loans totaled $780,000 past due 90 days or more and still accruing interest at June 30, 2009 compared with $102,000 and $9,000 on December 31, 2008 and June 30, 2008, respectively. There are no loans, other than those disclosed above as either non-performing or impaired, where information known about the borrower has caused management to have serious doubts about the borrower s ability to repay.

At June 30, 2009, there are no other interest-bearing assets that would be subject to disclosure as either non-performing or impaired.

At June 30, 2009, no concentration of loans to commercial borrowers engaged in similar activities exceeded 10% of total loans. The largest industry concentration at June 30, 2009 was approximately 5.24% of loans to the hospitality industry (hotels, motels, inns, etc.). For more information regarding the Bank s concentration of loans collateralized by real estate, please refer to the discussion under Risk Factors in Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2008 entitled We have a high concentration of loans secured by real estate and a downturn in the real estate market, for any reason, may increase our credit losses, which would negatively affect our financial results.

Based on recently enacted regulatory guidelines, the Bank is now required to monitor the commercial investment real estate loan portfolio for: (a) concentrations above 100% of Tier 1 capital and loan loss reserve for construction and land loans and (b) 300% for permanent investor real estate loans. As of June 30, 2009, construction and land loans were $43.0 million or 79.3% of the concentration limit. Commercial real estate loans, including construction and land loans, were $114.6 million or 211.2% of the concentration level.

The allowance for loan losses as a percentage of total loans increased from 1.08% at December 31, 2008 to 1.11% at June 30, 2009 in spite of the decline in non-accrual loans in order to reflect concerns about changes in the local economy, particularly the increase in the unemployment rate in Fauquier County, which increased from an average of 3.5% for 2008 to 5.6% for the first quarter of 2009.

Potential Problem Loans: For additional information regarding non-performing assets and potential loan problems, see Allowance for Loan Losses in Note 4 of the Notes to Consolidated Financial Statements contained herein.

CONTRACTUAL OBLIGATIONS

During March 2008, the Bank sold its Route 29 Warrenton branch building and land as part of an exchange of real estate properties. The property the Bank received, also on Route 29 in Warrenton, VA, will be the future site of a larger, more conveniently located branch building. During the time-period of construction of the new branch site, the Bank will rent the existing Route 29 Warrenton branch building for approximately $180,000 on an annualized basis.

During June 2009, the Company and Bank changed its third-party vendor providing core data processing services. There is no material change projected for data processing expense as result of this change in vendors for the remainder 2009.

As of June 30, 2009, there have been no other material changes outside the ordinary course of business to the contractual obligations disclosed in Management s Discussion and Analysis in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

OFF-BALANCE SHEET ARRANGEMENTS

As of June 30, 2009, there have been no material changes to the off-balance sheet arrangements disclosed in Management s Discussion and Analysis in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

CAPITAL

The Company and the Bank are subject to various regulatory capital requirements administered by banking agencies. Failure to meet minimum capital requirements can trigger certain mandatory and discretionary actions by regulators that could have a direct material effect on the Company s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total and Tier I Capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations), and of Tier I Capital to average assets (as defined in the regulations). Management believes, as of June 30, 2009, that the Company and the Bank more than satisfy all capital adequacy requirements to which they are subject.

At June 30, 2009 and December 31, 2008, the Company s regulatory capital ratios are set forth in the following table:

RISK BASED CAPITAL RATIOS
(Dollars in Thousands)

	June 30, 2009	December 31, 2008
Tier 1 Capital:		
Shareholders Equity	$ 41,389	$ 41,488
Plus: Unrealized loss on securities available for sale/FAS 158, net	2,758	2,217
Less: Unrealized loss on equity securities, net	(7)	(13)
Plus: Company-obligated madatorily redeemable capital securities	4,000	4,000
Total Tier 1 Capital	48,140	47,692
Tier 2 Capital:		
Allowable Allowance for Loan Losses	5,091	4,780
Total Capital:	53,231	52,472
Risk Weighted Assets:	$ 442,150	$ 416,265
Regulatory Capital Ratios:		
Leverage Ratio	9.14%	9.37%
Tier 1 to Risk Weighted Assets	10.89%	11.38%
Total Capital to Risk Weighted Assets	12.04%	12.52%

CAPITAL RESOURCES AND LIQUIDITY

Shareholders equity totaled $41.4 million at June 30, 2009 compared with $41.5 million at December 31, 2008 and $41.8 million at June 30, 2008. The amount of equity reflects management s desire to increase shareholders return on equity while maintaining a strong capital base. The Company initiated an open market stock buyback program in

1998, through which it repurchased no shares and 4,293 shares of stock during the first six months of 2009 and 2008, respectively.

Accumulated other comprehensive income/loss decreased to an unrealized loss net of tax benefit of $2.8 million at June 30, 2009 compared with $2.2 million at December 31, 2008. The decline in the accumulated other comprehensive loss was attributable to the increase in the unrealized loss on investment securities held available for sale, primarily the unrealized loss on the Bank s investment in pooled trust preferred securities.

As discussed above under Company-obligated Mandatorily Redeemable Capital Securities of Subsidiary Trust , in 2006, the Company established a subsidiary trust that issued $4.0 million of capital securities as part of a separate pooled trust preferred security offering with other financial institutions. Under applicable regulatory guidelines, the capital securities are treated as Tier 1 capital for purposes of the Federal Reserve s capital guidelines for bank holding companies, as long as the capital securities and all other cumulative preferred securities of the Company together do not exceed 25% of Tier 1 capital. As discussed above under Capital, banking regulations have established minimum capital requirements for financial institutions, including risk-based capital ratios and leverage ratios. As of June 30, 2009, the appropriate regulatory authorities have categorized the Company and the Bank as well capitalized.

The primary sources of funds are deposits, repayment of loans, maturities of investments, funds provided from operations, federal funds lines of credit with the Federal Reserve and other banks, and advances from the FHLB of Atlanta. While scheduled repayments of loans and maturities of investment securities are predictable sources of funds, deposit flows and loan repayments are greatly influenced by the general level of interest rates, economic conditions and competition. The Bank uses its sources of funds to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, to maintain liquidity, and to meet operating expenses. Management monitors projected liquidity needs and determines the desirable funding level based in part on the Bank s commitments to make loans and management s assessment of the Bank s ability to generate funds. Management is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on the liquidity, capital resources or operations of the Company or the Bank. Nor is management aware of any current recommendations by regulatory authorities that would have a material effect on liquidity, capital resources or operations. The Bank s internal sources of such liquidity are deposits, loan and investment repayments, and securities available for sale. The Bank s primary external sources of liquidity are federal funds lines of credit with the Federal Reserve Bank and other banks and advances from the FHLB of Atlanta.

Cash and amounts due from depository institutions, interest-bearing deposits in other banks, and federal funds sold totaled $9.4 million at June 30, 2009 compared with $11.0 million at December 31, 2008. These assets provide a primary source of liquidity for the Bank. In addition, management has designated the entire investment portfolio as available of sale, of which approximately $6.4 million was unpledged and readily salable at June 30, 2009. Furthermore, the Bank has an available line of credit with the FHLB of Atlanta with a borrowing limit of approximately $102.6 million at June 30, 2009 to provide additional sources of liquidity, as well as available federal funds purchased lines of credit with the Federal Reserve and various other commercial banks totaling approximately $86.0 million. At June 30, 2009, $45.0 million of the FHLB of Atlanta line of credit and $21.8 million of federal funds purchased lines of credit were in use.

Management is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on the liquidity, capital resources or operation of the Company or the Bank. Nor is management aware of any current recommendations by regulatory authorities that would have a material effect on liquidity, capital resources or operations.

The following table sets forth information relating to the Company s sources of liquidity and the outstanding commitments for use of liquidity at June 30, 2009 and December 31, 2008. The liquidity coverage ratio is derived by dividing the total sources of liquidity by the outstanding commitments for use of liquidity.

LIQUIDITY SOURCES AND USES
(Dollars in Thousands)

	June 30, 2009			December 31, 2008		
	Total	**In Use**	**Available**	**Total**	**In Use**	**Available**
Sources:						
Federal funds borrowing lines of credit	$ 86,010	$ 21,800	$ 64,210	$ 88,195	$ 18,275	$ 69,920
Federal Home Loan Bank advances	102,628	45,000	57,628	115,214	45,000	70,214
Federal funds sold	11		11			
Securities, available for sale and unpledged at fair value			6,353			8,428
Total short-term funding sources			$ 128,202			$ 148,562
Uses:						
Unfunded loan commitments and lending lines of credit			$ 83,897			$ 74,023
Letters of credit			9,491			5,366
Total potential short-term funding uses			$ 93,388			$ 79,389
Ratio of short-term funding sources to potential short-term funding uses			137.3%			187.1%

In addition to the outstanding commitments for use of liquidity displayed in the table above, the Bank will be utilizing approximately $2.8 million over the next twelve to thirty-nine months to complete the building of a new branch office in Haymarket, as well as move and expand its ViewTree branch office.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and the accompanying notes presented elsewhere in this document have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of the Company and the Bank are monetary in nature. The impact of inflation is reflected in the increased cost of operations. As a result, interest rates have a greater impact on our performance than inflation does. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

CHANGES IN ACCOUNTING PRINCIPLES

In September 2006, the Emerging Issues Task Force (EITF) issued EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. This consensus concludes that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with SFAS 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board (APB) Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007, with early application permitted. The effect that EITF 06-4 had on the Company s consolidated financial statement of condition for June 30, 2008 was a reduction in retained earnings of $12,000 and an increase in accrued benefit liabilities of $19,000.

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158). This Statement requires that employers measure plan assets and obligations as of the balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. The other provisions of SFAS 158 were implemented by the Company as of December 31, 2006. The effect that this provision of SFAS 158 had on The Company s consolidated financial statement of condition for June 30, 2009 was a reduction in retained earnings of $24,000 and an increase in accrued benefit liabilities of $37,000.

RECENT ACCOUNTING PROUNCEMENTS

Recent Accounting Pronouncements

In April 2009, FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies. 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 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 does not expect the adoption of FSP FAS 157-4 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. 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 does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its 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 are effective for interim and annual periods ending after June 15, 2009. The Company does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a material impact on its 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 Statement of Financial Accounting Standards No. 165, Subsequent Events. 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 does not expect the adoption of SFAS 165 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140. 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 Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R). 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 Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162. SFAS 168 establishes the FASB Accounting Standards Codification, which will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. 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 Securities and Exchange Commission issued Staff Accounting Bulletin 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 U.S. GAAP. The Company does not expect the adoption of SAB 112 to have a material impact on its consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

An important component of both earnings performance and liquidity is management of interest rate sensitivity. Interest rate sensitivity reflects the potential effect on net interest income and economic value of equity from a change in market interest rates. The Bank is subject to interest rate sensitivity to the degree that its interest-earning assets mature or reprice at different time intervals than its interest-bearing liabilities. However, the Company is not subject to the other major categories of market risk such as foreign currency exchange rate risk or commodity price risk. The Bank uses a number of tools to manage its interest rate risk, including simulating net interest income under various scenarios, monitoring the present value change in equity under the same scenarios, and monitoring the difference or gap between rate sensitive assets and rate sensitive liabilities over various time periods. Management believes that rate risk is best measured by simulation modeling.

There have been no material changes to the quantitative and qualitative disclosures made in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to provide assurance that the information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods required by the Securities and Exchange Commission. An evaluation of the effectiveness of the design and operations of the Company s disclosure controls and procedures at the end of the period covered by this report was carried out under the supervision and with the

participation of the management of Fauquier Bankshares, Inc., including the Chief Executive Officer and the Chief Financial Officer. Based on such an evaluation, the Chief Executive Officer and the Chief Financial Officer concluded the Company s disclosure controls and procedures were effective as of the end of such period.

As of June 30, 2009, management has assessed the effectiveness of the internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the assessment, management determined that it maintained effective internal control over the financial reporting as of June 30, 2009, based on those criteria, and the Company s Chief Executive Officer and Chief Financial Officer can provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

Smith Elliott Kearns & Company, LLC, the independent registered public accounting firm that audited the Company s consolidated financial statements included in the Company s Annual Report on 10-K for the year ended December 31, 2008, has issued an attestation report on the effectiveness of Management s internal control over reporting as of December 31, 2008. The report, which states an unqualified opinion on the effectiveness of Management s internal control over financial reporting as of December 31, 2008, is incorporated for reference in the Company s Annual Report on 10-K for the year ended December 31, 2008 in Item 8 under the heading Report of Independent Public Accounting Firm.

No changes were made in management s internal control over financial reporting during the quarter ended June 30, 2009 that have materially affected, or that are reasonably likely to materially affect, management s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no pending or threatened legal proceedings to which the Company or the Bank is a party or to which the property of either the Company or the Bank is subject to that, in the opinion of management, may materially impact the financial condition of either the Company or the Bank.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors faced by the Company from those disclosed in Company s Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None. On January 15, 2009, the Board authorized the Company to repurchase up to 106,929 shares (3% of common stock outstanding on January 1, 2009) beginning January 1, 2009. No shares were repurchased during the six months ended June 30, 2009.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

The Company held its Annual Meeting of Shareholders on May 19, 2009. A quorum of shareholders was present, consisting of a total of 2,932,352 shares, with 2,919,852 shares represented by proxy. At the Annual Meeting, the shareholders elected Class I directors John B. Adams. Jr., John J. Norman, Jr., Randolph D. Frostick, and Jay B. Keyser to three-year terms, and elected Class III directors C. H. Lawrence, Jr. and Eric P. Graap to two-year terms. The following Class II and Class III directors whose terms expire in 2009 and 2010 continued in office: Randy K.

Ferrell, Douglas C. Larson, Randolph T. Minter, Brian S. Montgomery, Jr., P. Kurtis Rodgers and Sterling T. Strange, III. The shareholders also ratified the selection of Smith Elliott Kearns & Company, LLC as independent auditors of the Company for the year ending December 31, 2009, ratified the amendment to the Company s Articles of Incorporation to revise the Article related to indemnification, and ratified the Fauquier Bankshares, Inc. Stock Incentive Plan. The shareholders did not ratify the amendment to the Company s Articles of Incorporation authorizing 2,000,000 shares of preferred stock.

The vote on each matter was as follows:

1. For Directors:

CLASS I NOMINEES	FOR	WITHHELD
John B. Adams, Jr.	2,905,786	26,566
Randolph D. Frostick	1,963,924	34,850
Jay B. Keyser	2,862,011	70,341
John J. Norman, Jr.	2,878,898	53,454
David M. van Roijen (not elected)	926,601	6,936

CLASS III NOMINEES	FOR	WITHHELD
Eric P. Graap	1,965,937	18,837
C. H. Lawrence, Jr.	2,877,899	54,453
C. Hunton Tiffany (not elected)	941,132	6,405

2. Ratification of the selection of Smith Elliott Kearns & Company, LLC as the independent auditors for the Company and the Bank for the 2009 year:

FOR	AGAINST	ABSTAIN	BROKER NON-VOTE
2,840,733	27,133	64,686	200

3. Ratification of the amendment to the Company s Articles of Incorporation authorizing 2,000,000 shares of preferred stock:

FOR	AGAINST	ABSTAIN	BROKER NON-VOTE
1,374,857	1,537,091	20,601	198

4. Ratification of the amendment to the Company s Articles of Incorporation to revise the Article related to indemnification:

FOR	AGAINST	ABSTAIN	BROKER NON-VOTE
2,818,018	45,634	68,898	199

5. Ratification of the Fauquier Bankshares, Inc. Stock Incentive Plan:

FOR	AGAINST	ABSTAIN	BROKER NON-VOTE
2,703,001	173,293	56,256	199

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number	**Exhibit Description**

3.1	Articles of Incorporation of Fauquier Bankshares, Inc., as amended, incorporated by reference to Exhibit 3(i) to registration statement on Form 10 filed April 16, 1999.

Exhibit Number	**Exhibit Description**
3.2	Bylaws of Fauquier Bankshares, Inc., as amended and restated, incorporated by reference to Exhibit 3.2 to Form 8-K filed November 15, 2007.
11	Refer to Part I, Item 1, Note 6 to the Consolidated Financial Statements.
31.1	Certification of CEO pursuant to Rule 13a-14(a).
31.2	Certification of CFO pursuant to Rule 13a-14(a).
32.1	Certification of CEO pursuant to 18 U.S.C. Section 1350.
32.2	Certification of CFO pursuant to 18 U.S.C. Section 1350.

SIGNATURES

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

FAUQUIER BANKSHARES, INC.
(Registrant)

/s/ Randy K. Ferrell
Randy K. Ferrell
President & Chief Executive Officer
Dated: August 7, 2009

/s/ Eric P. Graap
Eric P. Graap
Executive Vice President & Chief Financial
Officer
Dated: August 7, 2009