

FIRST COMMUNITY BANCSHARES INC /NV/

Form 10-Q

August 14, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarter ended June 30, 2012**

**Commission file number 000-19297**

**FIRST COMMUNITY BANCSHARES, INC.**

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

**Nevada**  
**(State or other jurisdiction)**

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

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of incorporation)

Identification No.)

P.O. Box 989

Bluefield, Virginia

(Address of principal executive offices)

24605-0989

(Zip Code)

(276) 326-9000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐

Accelerated filer ☒

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

Smaller reporting company ☐

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

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

Class Common Stock, \$1.00 Par Value; 20,008,181 shares outstanding as of August 3, 2012

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FORM 10-Q

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**FIRST COMMUNITY BANCSHARES, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

|                                                      | June 30,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|------------------------------------------------------|---------------------------------|----------------------|
| <i>(Amounts in thousands, except per share data)</i> |                                 |                      |
| <b>Assets</b>                                        |                                 |                      |
| Cash and due from banks                              | \$ 54,494                       | \$ 34,578            |
| Federal funds sold                                   | 64,815                          | 1,909                |
| Interest-bearing deposits in banks                   | 36,856                          | 10,807               |
| <br>Total cash and cash equivalents                  | <br>156,165                     | <br>47,294           |
| Securities available-for-sale                        | 526,607                         | 482,430              |
| Securities held-to-maturity                          | 1,295                           | 3,490                |
| Loans held for sale                                  | 1,179                           | 5,820                |
| Loans held for investment, net of unearned income:   |                                 |                      |
| Covered under loss share agreements                  | 238,777                         |                      |
| Not covered under loss share agreements              | 1,568,312                       | 1,396,067            |
| Less allowance for loan losses                       | 26,171                          | 26,205               |
| <br>Loans held for investment, net                   | <br>1,780,918                   | <br>1,369,862        |
| FDIC receivable under loss share agreements          | 52,067                          |                      |
| Property, plant, and equipment, net                  | 60,829                          | 54,721               |
| Other real estate owned:                             |                                 |                      |
| Covered under loss share agreements                  | 5,325                           |                      |
| Not covered under loss share agreements              | 4,938                           | 5,914                |
| Interest receivable                                  | 8,396                           | 6,193                |
| Goodwill                                             | 99,402                          | 83,056               |
| Intangible assets                                    | 3,903                           | 4,326                |
| Other assets                                         | 109,297                         | 101,683              |
| <br>Total assets                                     | <br>\$ 2,810,321                | <br>\$ 2,164,789     |
| <b>Liabilities</b>                                   |                                 |                      |
| Deposits:                                            |                                 |                      |
| Noninterest-bearing                                  | \$ 340,895                      | \$ 240,268           |
| Interest-bearing                                     | 1,764,312                       | 1,303,199            |
| <br>Total deposits                                   | <br>2,105,207                   | <br>1,543,467        |
| Interest, taxes, and other liabilities               | 22,465                          | 20,452               |
| Securities sold under agreements to repurchase       | 148,367                         | 129,208              |
| FHLB advances                                        | 176,653                         | 150,000              |
| Other borrowings                                     | 15,918                          | 15,933               |
| <br>Total liabilities                                | <br>2,468,610                   | <br>1,859,060        |

**Stockholders' equity**

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|                                                                                                                                                                                                                                                        |              |              |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Preferred stock, undesignated par value; 1,000,000 shares authorized: Series A                                                                                                                                                                         |              |              |
| Noncumulative Convertible Preferred Stock, \$0.01 par value; 25,000 shares authorized; 18,921 shares issued at June 30, 2012, and December 31, 2011                                                                                                    | 18,921       | 18,921       |
| Common stock, \$1 par value; 50,000,000 shares authorized; 20,239,827 and 18,082,822 shares issued at June 30, 2012, and December 31, 2011, respectively; 231,646 and 233,446 shares in treasury at June 30, 2012, and December 31, 2011, respectively | 20,240       | 18,083       |
| Additional paid-in capital                                                                                                                                                                                                                             | 212,510      | 188,118      |
| Retained earnings                                                                                                                                                                                                                                      | 99,418       | 93,656       |
| Treasury stock, at cost                                                                                                                                                                                                                                | (5,672)      | (5,721)      |
| Accumulated other comprehensive loss                                                                                                                                                                                                                   | (3,706)      | (7,328)      |
| Total stockholders' equity                                                                                                                                                                                                                             | 341,711      | 305,729      |
| Total liabilities and stockholders' equity                                                                                                                                                                                                             | \$ 2,810,321 | \$ 2,164,789 |

*See Notes to Consolidated Financial Statements.*

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

|                                                                | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|----------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                                | 2012                           | 2011      | 2012                         | 2011      |
| <i>(Amounts in thousands, except share and per share data)</i> |                                |           |                              |           |
| <b>Interest income</b>                                         |                                |           |                              |           |
| Interest and fees on loans held for investment                 | \$ 20,853                      | \$ 20,094 | \$ 40,221                    | \$ 40,549 |
| Interest on securities taxable                                 | 1,992                          | 1,850     | 4,071                        | 4,383     |
| Interest on securities nontaxable                              | 1,265                          | 1,291     | 2,461                        | 2,824     |
| Interest on deposits in banks                                  | 72                             | 100       | 111                          | 169       |
| Total interest income                                          | 24,182                         | 23,335    | 46,864                       | 47,925    |
| <b>Interest expense</b>                                        |                                |           |                              |           |
| Interest on deposits                                           | 2,360                          | 3,273     | 4,765                        | 7,153     |
| Interest on short-term borrowings                              | 589                            | 632       | 1,184                        | 1,272     |
| Interest on long-term borrowings                               | 1,749                          | 1,676     | 3,454                        | 3,471     |
| Total interest expense                                         | 4,698                          | 5,581     | 9,403                        | 11,896    |
| Net interest income                                            | 19,484                         | 17,754    | 37,461                       | 36,029    |
| Provision for loan losses                                      | 1,620                          | 3,079     | 2,542                        | 4,691     |
| Net interest income after provision for loan losses            | 17,864                         | 14,675    | 34,919                       | 31,338    |
| <b>Noninterest income</b>                                      |                                |           |                              |           |
| Wealth management income                                       | 940                            | 930       | 1,834                        | 1,824     |
| Service charges on deposit accounts                            | 3,329                          | 3,353     | 6,342                        | 6,384     |
| Other service charges and fees                                 | 1,564                          | 1,461     | 3,149                        | 2,867     |
| Insurance commissions                                          | 1,336                          | 1,561     | 2,912                        | 3,504     |
| Impairment losses on securities                                |                                |           |                              | (527)     |
| Portion of losses recognized in other comprehensive income     |                                |           |                              |           |
| Net impairment losses recognized in earnings                   |                                |           |                              | (527)     |
| Net gain on sale of securities                                 | (9)                            | 3,224     | 42                           | 5,060     |
| Other operating income                                         | 1,183                          | 834       | 2,055                        | 1,750     |
| Total noninterest income                                       | 8,343                          | 11,363    | 16,334                       | 20,862    |
| <b>Noninterest expense</b>                                     |                                |           |                              |           |
| Salaries and employee benefits                                 | 8,892                          | 8,685     | 17,114                       | 17,814    |
| Occupancy expense of bank premises                             | 1,654                          | 1,568     | 3,180                        | 3,215     |
| Furniture and equipment                                        | 975                            | 909       | 1,786                        | 1,824     |
| Amortization of intangible assets                              | 189                            | 261       | 422                          | 520       |
| FDIC premiums and assessments                                  | 290                            | 414       | 612                          | 1,292     |
| FHLB debt prepayment fees                                      |                                |           |                              | 471       |
| Merger related expense                                         | 3,419                          |           | 3,582                        |           |
| Other operating expense                                        | 4,713                          | 5,901     | 9,629                        | 10,665    |
| Total noninterest expense                                      | 20,132                         | 17,738    | 36,325                       | 35,801    |

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|                                             |            |            |            |            |
|---------------------------------------------|------------|------------|------------|------------|
| Income before income taxes                  | 6,075      | 8,300      | 14,928     | 16,399     |
| Income tax expense                          | 1,997      | 2,572      | 4,849      | 4,920      |
| Net income                                  | 4,078      | 5,728      | 10,079     | 11,479     |
| Dividends on preferred stock                | 283        | 131        | 566        | 131        |
| Net income available to common shareholders | \$ 3,795   | \$ 5,597   | \$ 9,513   | \$ 11,348  |
| Basic earnings per common share             | \$ 0.20    | \$ 0.31    | \$ 0.52    | \$ 0.63    |
| Diluted earnings per common share           | \$ 0.20    | \$ 0.31    | \$ 0.52    | \$ 0.63    |
| Cash dividends per common share             | \$ 0.11    | \$ 0.10    | \$ 0.21    | \$ 0.20    |
| Weighted average basic shares outstanding   | 18,561,714 | 17,895,904 | 18,205,545 | 17,882,006 |
| Weighted average diluted shares outstanding | 19,909,242 | 18,534,489 | 19,549,582 | 18,200,184 |

*See Notes to Consolidated Financial Statements.*

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

|                                                                                                                | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                  |
|----------------------------------------------------------------------------------------------------------------|---------------------------|-----------------|-------------------------|------------------|
|                                                                                                                | <b>June 30,</b>           |                 | <b>June 30,</b>         |                  |
|                                                                                                                | <b>2012</b>               | <b>2011</b>     | <b>2012</b>             | <b>2011</b>      |
| <i>(Amounts in thousands, except share and per share data)</i>                                                 |                           |                 |                         |                  |
| <b>Net income</b>                                                                                              | <b>\$ 4,078</b>           | <b>\$ 5,728</b> | <b>\$ 10,079</b>        | <b>\$ 11,479</b> |
| Other comprehensive income, before tax                                                                         |                           |                 |                         |                  |
| Available-for-sale securities:                                                                                 |                           |                 |                         |                  |
| Unrealized gains on securities available-for-sale with other-than-temporary impairment                         | (314)                     | (964)           | (105)                   | (21)             |
| Unrealized gains on securities available-for-sale without other-than-temporary impairment                      | 5,326                     | 6,387           | 5,821                   | 12,479           |
| Less: reclassification adjustment for losses (gains) realized in net income                                    | 9                         | (3,224)         | (42)                    | (5,060)          |
| Less: reclassification adjustment for credit related other-than-temporary impairments recognized in net income |                           |                 |                         | 527              |
| Unrealized gains on available-for-sale securities in OCI                                                       | 5,021                     | 2,199           | 5,674                   | 7,925            |
| Defined benefit plans:                                                                                         |                           |                 |                         |                  |
| Less: reclassification adjustment for amortization in net prior service cost                                   | 106                       |                 | 150                     |                  |
| Unrealized gains on benefit plans                                                                              | 106                       |                 | 150                     |                  |
| Derivative securities:                                                                                         |                           |                 |                         |                  |
| Unrealized gains on derivative securities                                                                      |                           |                 |                         | 30               |
| Other comprehensive income (loss), before tax                                                                  | 5,127                     | 2,199           | 5,823                   | 7,955            |
| Income tax expense related to items of other comprehensive income                                              | (1,938)                   | (819)           | (2,201)                 | (2,963)          |
| Other comprehensive income, net of tax                                                                         | 3,189                     | 1,380           | 3,622                   | 4,992            |
| <b>Total comprehensive income</b>                                                                              | <b>\$ 7,267</b>           | <b>\$ 7,108</b> | <b>\$ 13,701</b>        | <b>\$ 16,471</b> |

*See Notes to Consolidated Financial Statements.*

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

| <i>(Amounts in thousands, except share and per share data)</i> | <b>Preferred Stock</b> | <b>Common Stock</b> | <b>Additional Paid-in Capital</b> | <b>Retained Earnings</b> | <b>Treasury Stock</b> | <b>Accumulated Other Comprehensive Income (Loss)</b> | <b>Total</b> |
|----------------------------------------------------------------|------------------------|---------------------|-----------------------------------|--------------------------|-----------------------|------------------------------------------------------|--------------|
| <b>Balance January 1, 2011</b>                                 | \$                     | \$ 18,083           | \$ 189,239                        | \$ 81,486                | \$ (6,740)            | \$ (12,190)                                          | \$ 269,878   |
| Comprehensive income                                           |                        |                     |                                   |                          |                       |                                                      |              |
| Net income                                                     |                        |                     |                                   | 11,479                   |                       |                                                      | 11,479       |
| Other comprehensive income                                     |                        |                     |                                   |                          |                       | 4,992                                                | 4,992        |
| Comprehensive income, net of tax                               |                        |                     |                                   | 11,479                   |                       | 4,992                                                | 16,471       |
| Common dividends declared \$0.20 per share                     |                        |                     |                                   | (3,577)                  |                       |                                                      | (3,577)      |
| Preferred dividends declared \$6.90 per share                  |                        |                     |                                   | (131)                    |                       |                                                      | (131)        |
| Issuance of preferred stock 18,921 shares                      | 18,921                 |                     | (80)                              |                          |                       |                                                      | 18,841       |
| Equity-based compensation expense                              |                        |                     | (9)                               |                          | 30                    |                                                      | 21           |
| Common stock options exercised 2,969 shares                    |                        |                     | (60)                              |                          | 92                    |                                                      | 32           |
| Issuance of treasury stock to 401(k) plan 47,570 shares        |                        |                     | (812)                             |                          | 1,481                 |                                                      | 669          |
| <b>Balance June 30, 2011</b>                                   | \$ 18,921              | \$ 18,083           | \$ 188,278                        | \$ 89,257                | \$ (5,137)            | \$ (7,198)                                           | \$ 302,204   |
| <b>Balance January 1, 2012</b>                                 | \$ 18,921              | \$ 18,083           | \$ 188,118                        | \$ 93,656                | \$ (5,721)            | \$ (7,328)                                           | \$ 305,729   |
| Comprehensive income                                           |                        |                     |                                   |                          |                       |                                                      |              |
| Net income                                                     |                        |                     |                                   | 10,079                   |                       |                                                      | 10,079       |
| Other comprehensive income                                     |                        |                     |                                   |                          |                       | 3,622                                                | 3,622        |
| Comprehensive income, net of tax                               |                        |                     |                                   | 10,079                   |                       | 3,622                                                | 13,701       |
| Common dividends declared \$0.21 per share                     |                        |                     |                                   | (3,751)                  |                       |                                                      | (3,751)      |
| Preferred dividends declared \$30.00 per share                 |                        |                     |                                   | (566)                    |                       |                                                      | (566)        |
| Equity-based compensation expense                              |                        |                     | 94                                |                          | 17                    |                                                      | 111          |
| Common stock options exercised 1,300 shares                    |                        |                     | (15)                              |                          | 32                    |                                                      | 17           |
| Acquisition of Peoples Bank of Virginia 2,157,005 shares       |                        | 2,157               | 24,313                            |                          |                       |                                                      | 26,470       |
| <b>Balance June 30, 2012</b>                                   | \$ 18,921              | \$ 20,240           | \$ 212,510                        | \$ 99,418                | \$ (5,672)            | \$ (3,706)                                           | \$ 341,711   |

See Notes to Consolidated Financial Statements.

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

|                                                                                   | <b>Six Months Ended<br/>June 30,</b> |                |
|-----------------------------------------------------------------------------------|--------------------------------------|----------------|
|                                                                                   | <b>2012</b>                          | <b>2011</b>    |
| <i>(Amounts in thousands)</i>                                                     |                                      |                |
| <b>Operating activities</b>                                                       |                                      |                |
| Net income                                                                        | \$ 10,079                            | \$ 11,479      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                      |                |
| Provision for loan losses                                                         | 2,542                                | 4,691          |
| Depreciation and amortization of property, plant, and equipment                   | 1,887                                | 2,034          |
| Accretion of discounts and premiums on investments                                | 964                                  | 162            |
| Amortization of intangible assets                                                 | 422                                  | 520            |
| Gain on sale of loans                                                             | (475)                                | (406)          |
| Equity-based compensation expense                                                 | 111                                  | 21             |
| Contribution of treasury stock to 401(k) plan                                     |                                      | 1,481          |
| Gain (loss) on sale of property, plant, and equipment                             | 54                                   | (32)           |
| Losses on sales of other real estate                                              | 825                                  | 1,233          |
| Gain on sale of securities                                                        | (42)                                 | (5,060)        |
| Net impairment losses recognized in earnings                                      |                                      | 527            |
| Losses on payments of FHLB debt prepayment fees                                   |                                      | 471            |
| Deferred income tax expense                                                       | 8,445                                | 2,618          |
| Proceeds from sale of mortgage loans                                              | 34,658                               | 23,884         |
| Origination of mortgage loans                                                     | (29,542)                             | (19,704)       |
| (Increase) decrease in accrued interest receivable                                | (176)                                | 1,473          |
| (Increase) decrease in other operating activities                                 | (1,526)                              | 157            |
| <b>Net cash provided by operating activities</b>                                  | <b>28,226</b>                        | <b>25,549</b>  |
| <b>Investing activities</b>                                                       |                                      |                |
| Proceeds from sale of securities available-for-sale                               | 20,649                               | 182,167        |
| Proceeds from maturities, prepayments, and calls of securities available-for-sale | 43,019                               | 19,317         |
| Proceeds from maturities, prepayments, and calls of securities held-to-maturity   | 2,210                                | 535            |
| Payments to acquire securities available-for-sale                                 | (40,801)                             | (59,334)       |
| Origination of loans                                                              | 3,517                                | 2,506          |
| Proceeds from FHLB stock                                                          | 504                                  | 736            |
| Net cash acquired in acquisitions                                                 | 152,774                              |                |
| Payments to acquire property, plant, and equipment                                | (1,500)                              | (1,799)        |
| Proceeds from sale of property, plant, and equipment                              | 887                                  | 175            |
| Proceeds from sale of other real estate                                           | 2,685                                | 3,157          |
| <b>Net cash provided by investing activities</b>                                  | <b>183,944</b>                       | <b>147,460</b> |
| <b>Financing activities</b>                                                       |                                      |                |
| Net increase in noninterest-bearing deposits                                      | 10,191                               | 14,337         |
| Net increase (decrease) in interest-bearing deposits                              | (97,634)                             | (55,616)       |
| Repayments of securities sold under agreements to repurchase                      | (923)                                | (3,116)        |
| Repayments of long-term debt                                                      | (10,633)                             | (25,014)       |
| Proceeds from issuance of preferred stock                                         |                                      | 18,841         |
| Proceeds from stock options exercised                                             | 17                                   | 32             |
| Payments of FHLB debt prepayment fees                                             |                                      | (471)          |
| Excess tax benefit from share-based compensation                                  |                                      | 5              |
| Payments of common dividends                                                      | (3,751)                              | (3,577)        |
| Payments of preferred dividends                                                   | (566)                                |                |

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|                                                        |            |            |
|--------------------------------------------------------|------------|------------|
| Net cash used in financing activities                  | (103,299)  | (54,579)   |
| Increase in cash and cash equivalents                  | 108,871    | 118,430    |
| Cash and cash equivalents at beginning of period       | 47,294     | 112,189    |
| Cash and cash equivalents at end of period             | \$ 156,165 | \$ 230,619 |
| <b>Supplemental information    noncash items</b>       |            |            |
| Transfer of other real estate                          | \$ 3,311   | \$ 5,065   |
| Loans originated to finance other real estate          | \$ 840     |            |
| <i>See Notes to Consolidated Financial Statements.</i> |            |            |

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. General**

The accompanying unaudited condensed consolidated financial statements of First Community Bancshares, Inc. and subsidiaries ( First Community or the Company ) have been prepared in accordance with generally accepted accounting principles in the United States ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments, including normal recurring accruals, necessary for a fair presentation have been made. All significant intercompany balances and transactions have been eliminated in consolidation. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full calendar year. The Company has made certain reclassifications of prior period information necessary to conform to the current period presentation. These reclassifications had no effect on the Company s financial position, results of operations, or stockholders equity.

The condensed consolidated balance sheet as of December 31, 2011, has been derived from the audited consolidated financial statements included in the Company s 2011 Annual Report on Form 10-K (the 2011 Form 10-K ), as filed with the Securities and Exchange Commission (the SEC ) on March 2, 2012. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with GAAP have been omitted in accordance with standards for the preparation of interim consolidated financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2011 Form 10-K.

The Company operates in one business segment, Community Banking. The Community Banking segment consists of all operations, including commercial and consumer banking, lending activities, wealth management, and insurance services.

***Significant Accounting Policies***

A complete and detailed description of the Company s significant accounting policies is included in Note 1, Summary of Significant Accounting Policies, of the Notes to Condensed Consolidated Financial Statements in Part II, Item 8, Financial and Supplementary Data, of the Company s 2011 Form 10-K and Note 1, General, of the Notes to Consolidated Financial Statements in Part I, Item 1, Financial Statements, of the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2012. Additional discussion of the Company s application of critical accounting estimates is included within Application of Critical Accounting Estimates in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, herein.

***Recent Accounting Pronouncements***

There were no recent accounting pronouncements that had, or are likely to have, a material effect on the Company s financial position or results of operations.

**Table of Contents****Note 2. Earnings Per Common Share**

Basic earnings per common share is determined by dividing net income available to common shareholders by the weighted average common shares outstanding. Diluted earnings per common share is determined by dividing net income by the weighted average common shares outstanding, including diluted shares for stock options, warrants, contingently issuable shares, and convertible preferred shares. The calculation for basic and diluted earnings per common share follows:

|                                                         | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---------------------------------------------------------|--------------------------------|------------|------------------------------|------------|
| (Amounts in thousands, except share and per share data) | 2012                           | 2011       | 2012                         | 2011       |
| Net income                                              | \$ 4,078                       | \$ 5,728   | \$ 10,079                    | \$ 11,479  |
| Dividends on preferred stock                            | 283                            | 131        | 566                          | 131        |
| Net income available to common shareholders             | \$ 3,795                       | \$ 5,597   | \$ 9,513                     | \$ 11,348  |
| Weighted average common shares outstanding, basic       | 18,561,714                     | 17,895,904 | 18,205,545                   | 17,882,006 |
| Diluted shares for stock options                        | 41,979                         | 27,497     | 38,488                       | 6,706      |
| Contingently issuable shares                            |                                | 8,527      |                              | 8,527      |
| Convertible preferred shares                            | 1,305,549                      | 602,561    | 1,305,549                    | 302,945    |
| Weighted average common shares outstanding, diluted     | 19,909,242                     | 18,534,489 | 19,549,582                   | 18,200,184 |
| Basic earnings per common share                         | \$ 0.20                        | \$ 0.31    | \$ 0.52                      | \$ 0.63    |
| Diluted earnings per common share                       | \$ 0.20                        | \$ 0.31    | \$ 0.52                      | \$ 0.63    |

The 18,921 shares of the Company's Series A Noncumulative Convertible Preferred Stock ( Series A Preferred Stock ) carry a 6% dividend rate. Each share is convertible into 69 shares of Common Stock at any time and mandatorily converts after five years. The Company may redeem the shares at face value after May 20, 2014.

The following outstanding options and warrants to purchase the Company's Common Stock ( Common Stock ) were excluded from the calculation of diluted earnings per share because the exercise price was greater than the market value of the Common Stock, which would result in an antidilutive effect on diluted earnings per share:

|                      | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|----------------------|--------------------------------|---------|------------------------------|---------|
|                      | 2012                           | 2011    | 2012                         | 2011    |
| Options and warrants | 451,915                        | 457,045 | 451,915                      | 480,396 |

**Note 3. Business Combinations**

The Company accounts for business combinations under FASB ASC 805 which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC Topic 820, Fair Value Measurements and Disclosures, exclusive of the loss share agreements with the Federal Deposit Insurance Corporation (the FDIC ). The fair value estimates associated with the loans include estimates related to expected prepayments and the amount and timing of expected principal, interest, and other cash flows. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding the closing date fair values becomes available.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, Receivables Loans and Debt Securities Acquired with Deteriorated Credit Quality, formerly American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) 03-3, Accounting for Certain Loans or Debt Securities

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Acquired in a Transfer, and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans exhibit evidence of credit deterioration when it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration, as of the purchase date, may include measures such as nonaccrual status, credit scores, declines in collateral value, current loan to value percentages, and days past due. The

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Company considers expected prepayments and estimates the amount and timing of expected principal, interest, and other cash flows for each loan or pool of loans meeting the criteria above, and determines the excess of the loan's scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the loan's or pool's cash flows expected to be collected over the amount deemed paid for the loan or pool of loans, is accreted into interest income over the remaining life of the loan or pool (accretable yield). The Company records a discount on these loans at acquisition to record them at their realizable cash flows. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference which is included in the carrying amount of the loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reversal of the nonaccretable difference with a positive impact on interest income prospectively. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. In accordance with FASB ASC Topic 310-30, the Company aggregated loans that have common risk characteristics into pools within the following loan categories: construction and development, commercial and industrial, commercial real estate, consumer, home equity lines of credit, residential real estate – 1st lien, residential real estate – 2nd lien, and lines of credit.

Purchased performing loans are recorded at fair value and include credit and interest rate marks associated with acquisition accounting adjustments, as accounted for under the contractual cash flow method of accounting. The fair value adjustment is accreted as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. A provision for loan losses is recorded for any credit deterioration in these loans subsequent to the acquisition. In accordance with GAAP, there was no carryover of previously established allowance for loan losses on acquired portfolios.

***Peoples Bank of Virginia***

On May 31, 2012, the Company completed the acquisition of Peoples Bank of Virginia (Peoples), a commercial bank headquartered in Richmond, Virginia. At acquisition, Peoples had total assets of \$276.88 million, total loans of \$184.84 million, total deposits of \$232.75 million, and common equity of \$43.38 million. The transaction was accounted for under the purchase method of accounting and accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair value on the acquisition date. The acquisition expands the Company's existing presence in the Richmond, Virginia market by four branches and affords the opportunity to realize certain operating cost savings.

Peoples' shareholders received \$6.08 in cash and 1.07 shares of the Company's Common Stock for each share of Peoples' common stock resulting in a purchase price of approximately \$40.28 million, which includes Common Stock valued at \$26.47 million and total cash consideration of \$12.26 million. In connection with the transaction, the Company issued 2,157,005 shares of Common Stock valued based on the five-day variable weighted average price of \$12.27 for the two days immediately preceding, two days immediate proceeding, and including May 31, 2012. The preliminary purchase price has been allocated to the identifiable tangible and intangible assets resulting in an addition to goodwill of \$9.02 million. Because the consideration paid was greater than the net fair value of the assets acquired and liabilities assumed, the Company recorded goodwill as part of the acquisition. The Company does not expect any goodwill recorded in connection with the acquisition to be deductible for tax purposes.

The Company estimated the fair value of assets acquired and liabilities assumed using expected cash flows discounted at appropriate rates of interest. The estimated fair values, including identifiable intangible assets, are preliminary and subject to refinement for up to one year after the closing date of the acquisition.

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The consideration transferred and the net assets acquired in connection with the Peoples acquisition are presented as of the acquisition date:

*(Amounts in thousands, except per share data)*

|                                       |               |
|---------------------------------------|---------------|
| <b>Consideration</b>                  |               |
| Cash consideration                    | \$ 12,259     |
| Common stock 2,157,005 shares         | 26,469        |
| Cash in lieu of fractional shares     | 2             |
| Stock option consideration            | 1,547         |
| <br>Fair value of consideration paid  | <br>\$ 40,277 |
| <b>Identifiable assets</b>            |               |
| Cash and cash equivalents             | \$ 81,834     |
| Securities                            | 2,917         |
| Loans                                 | 166,609       |
| Property, plant, and equipment        | 3,434         |
| Other assets                          | 11,354        |
| <br>Identifiable assets               | <br>266,148   |
| <b>Identifiable liabilities</b>       |               |
| Total deposits                        | 234,146       |
| Other liabilities                     | 741           |
| <br>Identifiable liabilities          | <br>234,887   |
| Identifiable net assets acquired      | 31,261        |
| <br>Goodwill recorded for acquisition | <br>\$ 9,016  |

The Company is currently in the process of identifying the purchased performing and credit impaired loans from the Peoples acquisition; therefore, disclosures related to the division of the purchased loans have been omitted in this current quarterly filing.

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The Company's operating results for the three and six months ended June 30, 2012, include the impact of the Peoples acquisition since May 31, 2012. The following table presents unaudited proforma information as if the acquisition had occurred on January 1, 2011. The information presented does not necessarily reflect the results of operation that would have occurred had the acquisition been completed at the beginning of each fiscal period, nor does it indicate future consolidated results. For the three and six months ended June 30, 2012, the Company incurred merger related expenses related to the Peoples acquisition of \$2.83 million and \$2.99 million, respectively.

| <b>For the Six Months Ended June 30, 2012</b>       |                        |                |                             |                          |
|-----------------------------------------------------|------------------------|----------------|-----------------------------|--------------------------|
| <i>(Amounts in thousands)</i>                       | <b>First Community</b> | <b>Peoples</b> | <b>Proforma Adjustments</b> | <b>Proforma Combined</b> |
| Interest income                                     | \$ 46,013              | \$ 5,479       | \$                          | \$ 51,492                |
| Interest expense                                    | 9,212                  | 1,521          | (122)                       | 10,611                   |
| Net interest income                                 | 36,801                 | 3,958          | 122                         | 40,881                   |
| Provision for loan losses                           | 2,542                  | 100            |                             | 2,642                    |
| Net interest income after provision for loan losses | 34,259                 | 3,858          | 122                         | 38,239                   |
| Noninterest income                                  | 16,287                 | 254            |                             | 16,541                   |
| Noninterest expense <sup>(1)</sup>                  | 33,188                 | 2,932          | 2,988                       | 39,108                   |
| Income (loss) before taxes                          | 17,358                 | 1,180          | (2,866)                     | 15,672                   |
| Income tax expense (benefit)                        | 5,852                  | 397            | (1,133)                     | 5,116                    |
| Net income (loss)                                   | 11,506                 | 783            | (1,733)                     | 10,556                   |
| Dividends on preferred stock                        | 566                    |                |                             | 566                      |
| Net income (loss) available to common shareholders  | \$ 10,940              | \$ 783         | \$ (1,733)                  | \$ 9,990                 |

  

| <b>For the Six Months Ended June 30, 2011</b>       |                        |                |                             |                          |
|-----------------------------------------------------|------------------------|----------------|-----------------------------|--------------------------|
|                                                     | <b>First Community</b> | <b>Peoples</b> | <b>Proforma Adjustments</b> | <b>Proforma Combined</b> |
| Interest income                                     | \$ 47,925              | \$ 6,337       | \$                          | \$ 54,262                |
| Interest expense                                    | 11,896                 | 1,800          | (122)                       | 13,574                   |
| Net interest income                                 | 36,029                 | 4,537          | 122                         | 40,688                   |
| Provision for loan losses                           | 4,691                  | 750            |                             | 5,441                    |
| Net interest income after provision for loan losses | 31,338                 | 3,787          | 122                         | 35,247                   |
| Noninterest income                                  | 20,862                 | 226            |                             | 21,088                   |
| Noninterest expense <sup>(1)</sup>                  | 35,801                 | 2,489          | 2,988                       | 41,278                   |
| Income (loss) before taxes                          | 16,399                 | 1,524          | (2,866)                     | 15,057                   |
| Income tax expense (benefit)                        | 4,920                  | 513            | (1,133)                     | 4,300                    |
| Net income (loss)                                   | 11,479                 | 1,011          | (1,733)                     | 10,757                   |
| Dividends on preferred stock                        | 131                    |                |                             | 131                      |
| Net income (loss) available to common shareholders  | \$ 11,348              | \$ 1,011       | \$ (1,733)                  | \$ 10,626                |

(1) Proforma adjustments in noninterest expense result from merger related expense.

***Waccamaw Bank***

On June 8, 2012, the Company's wholly-owned subsidiary, First Community Bank (the Bank), entered into a Purchase and Assumption Agreement (the Agreement) with loss share arrangements with the FDIC to purchase certain assets and assume substantially all of the deposits and certain liabilities of Waccamaw Bank (Waccamaw), a full service community bank, headquartered in Whiteville, North Carolina. Waccamaw operated sixteen branches in total throughout North Carolina and South Carolina.

Pursuant to the Agreement, the Bank received a discount of \$15.00 million on the assets acquired and did not pay the FDIC a premium to assume all customer deposits. Most of the loans and foreclosed real estate purchased are covered by loss share agreements between the FDIC and the Bank. Under the loss share agreements, the FDIC will cover 80% of loan and foreclosed real estate losses and certain collection costs. Gains and recoveries on covered assets will offset losses, or be paid to the FDIC, at the applicable loss share percentage at the time of recovery. The loss sharing agreement applicable to single family assets, both loans and OREO, provides for FDIC loss sharing and Bank reimbursement to the FDIC for ten years. The loss share agreement applicable to commercial assets, both loans and OREO, provides for FDIC loss sharing for five years and Bank reimbursement of recoveries to the FDIC for eight years. As of the date of acquisition, we calculated the amount of such reimbursements that we expect to receive from the FDIC using the present value of anticipated cash flows from the loss

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sharing based on the adjustments estimated for each pool of loans and the estimated losses on foreclosed assets. In accordance with FASB ASC Topic 805, the FDIC indemnification asset was initially recorded at its fair value, and is measured separately from the loan assets and foreclosed assets because the loss sharing agreements are not contractually embedded in them or transferable with them in the event of disposal. The balance of the FDIC indemnification asset increases and decreases as the expected and actual cash flows from the covered assets fluctuate, as loans are paid off or impaired and as loans and foreclosed assets are sold. There are no contractual interest rates on this contractual receivable from the FDIC; however, a discount was recorded against the initial balance of the FDIC indemnification asset in conjunction with the fair value measurement as this receivable will be collected over the term of the loss sharing agreement. This discount will be accreted to non-interest income over future periods.

The Bank did not immediately acquire all the real estate, furniture, and equipment of Waccamaw as a part of the purchase agreement. The bank purchased two properties at acquisition; however, the Bank has the option to purchase the remaining real estate, furniture, and equipment from the FDIC. The term of this option expires approximately 30 days from the date of the acquisition; additionally, the Bank has approximately 90 days to assume or repudiate leases for leased branch properties.

As of June 30, 2012, there have been no adjustments or changes to the initial fair values related to the Waccamaw acquisition. The purchase accounting adjustments and the loss sharing arrangement with the FDIC significantly impact the effects of the acquired entity on the ongoing operations of the Company. Additionally, disclosure of pro forma financial information is made more difficult by the nature of Waccamaw's operations prior to the date of the combination. Accordingly, no pro forma financial information has been presented.

Goodwill of \$7.13 million was recorded as part of the acquisition of Waccamaw. The amount of the goodwill was equal to the amount by which the fair value of liabilities assumed exceeded the fair value of assets acquired, and resulted from the discount bid on the assets acquired and the impact of the FDIC loss share agreements. For the three and six months ended June 30, 2012, the Company incurred merger related expenses related to the Waccamaw acquisition of \$594 thousand.

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The following table presents the assets acquired and liabilities assumed as of June 8, 2012, as recorded by Waccamaw on the acquisition date and as adjusted for purchase accounting adjustments:

| <i>(Amounts in thousands)</i>                          | <b>Balances Acquired<br/>from FDIC</b> | <b>Fair Value and<br/>Purchase<br/>Adjustments</b> | <b>Recorded<br/>Investment</b> |
|--------------------------------------------------------|----------------------------------------|----------------------------------------------------|--------------------------------|
| <b>Assets</b>                                          |                                        |                                                    |                                |
| Cash and due from banks <sup>(1)</sup>                 | \$ 44,809                              | \$                                                 | \$ 44,809                      |
| Interest-bearing deposits in banks                     | 40,140                                 |                                                    | 40,140                         |
| Total cash and cash equivalents                        | 84,949                                 |                                                    | 84,949                         |
| Securities available-for-sale                          | 59,816                                 | (194)                                              | 59,622                         |
| Loans held for investment, net of unearned income      | 318,317                                | (65,464)                                           | 252,853                        |
| FDIC receivable under loss share agreements            |                                        | 52,067                                             | 52,067                         |
| Property, plant, and equipment, net                    | 4,102                                  |                                                    | 4,102                          |
| Other real estate owned                                | 9,347                                  | (3,959)                                            | 5,388                          |
| Interest receivable                                    | 1,363                                  |                                                    | 1,363                          |
| Other assets                                           | 5,264                                  |                                                    | 5,264                          |
| Total assets                                           | \$ 483,158                             | \$ (17,550)                                        | \$ 465,608                     |
| <b>Liabilities</b>                                     |                                        |                                                    |                                |
| Deposits:                                              |                                        |                                                    |                                |
| Noninterest-bearing                                    | \$ 47,892                              | \$                                                 | \$ 47,892                      |
| Interest-bearing                                       | 366,233                                | 912                                                | 367,145                        |
| Total deposits                                         | 414,125                                | 912                                                | 415,037                        |
| Securities sold under agreements to repurchase         | 17,042                                 | 3,040                                              | 20,082                         |
| FHLB advances                                          | 35,000                                 | 2,271                                              | 37,271                         |
| Other borrowings                                       | 345                                    |                                                    | 345                            |
| Total liabilities                                      | \$ 466,512                             | \$ 6,223                                           | \$ 472,735                     |
| Net assets acquired over (under) liabilities assumed   | \$ 16,646                              | \$ (23,773)                                        | \$ (7,127)                     |
| Excess of net assets acquired over liabilities assumed | \$ 16,646                              |                                                    |                                |
| Aggregate fair value and purchase adjustments          |                                        | \$ (23,773)                                        |                                |
| Goodwill on acquisition                                |                                        |                                                    | \$ 7,127                       |

(1) Includes \$17.27 million transferred to the FDIC in connection with the acquisition.

The Company is currently in the process of identifying the purchased performing and credit impaired loans from the Waccamaw acquisition; therefore, disclosures related to the division of the purchased loans have been omitted in this current quarterly filing.

The following table presents fair value of loans acquired from Peoples and Waccamaw at their acquisition date. The amounts include principal only and do not reflect accrued interest as of the date of the acquisition or beyond:

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| <i>(Amounts in thousands)</i>                                     | <b>Peoples<br/>May 31, 2012</b> | <b>Waccamaw<br/>June 8, 2012</b> |
|-------------------------------------------------------------------|---------------------------------|----------------------------------|
| Contractually required principal payments receivable              | \$ 185,624                      | \$ 328,939                       |
| Fair value of adjustment for credit, interest rate, and liquidity | (19,015)                        | (76,086)                         |
| Fair value of loans receivable                                    | \$ 166,609                      | \$ 252,853                       |

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### Note 4. Investment Securities

The amortized cost and estimated fair value of available-for-sale securities, including gross unrealized gains and losses, at June 30, 2012, and December 31, 2011, were as follows:

| (Amounts in thousands)                  | June 30, 2012  |                  |                   |            |                             |
|-----------------------------------------|----------------|------------------|-------------------|------------|-----------------------------|
|                                         | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value | OTTI in AOCI <sup>(1)</sup> |
| Municipal securities                    | \$ 144,940     | \$ 7,249         | \$ (198)          | \$ 151,991 | \$                          |
| Single issue trust preferred securities | 55,678         |                  | (11,172)          | 44,506     |                             |
| Corporate FDIC insured securities       | 13,540         | 10               |                   | 13,550     |                             |
| Mortgage-backed securities:             |                |                  |                   |            |                             |
| Agency                                  | 300,036        | 6,310            | (257)             | 306,089    |                             |
| Non-Agency Alt-A residential            | 15,533         |                  | (5,607)           | 9,926      | (5,607)                     |
| Total mortgage-backed securities        | 315,569        | 6,310            | (5,864)           | 316,015    | (5,607)                     |
| Equity securities                       | 419            | 220              | (94)              | 545        |                             |
| Total                                   | \$ 530,146     | \$ 13,789        | \$ (17,328)       | \$ 526,607 | \$ (5,607)                  |

| (Amounts in thousands)                  | December 31, 2011 |                  |                   |            |                             |
|-----------------------------------------|-------------------|------------------|-------------------|------------|-----------------------------|
|                                         | Amortized Cost    | Unrealized Gains | Unrealized Losses | Fair Value | OTTI in AOCI <sup>(1)</sup> |
| Municipal securities                    | \$ 131,498        | \$ 6,317         | \$                | \$ 137,815 | \$                          |
| Single issue trust preferred securities | 55,649            |                  | (15,405)          | 40,244     |                             |
| Corporate FDIC insured securities       | 13,685            | 33               |                   | 13,718     |                             |
| Mortgage-backed securities:             |                   |                  |                   |            |                             |
| Agency                                  | 274,384           | 6,003            | (285)             | 280,102    |                             |
| Non-Agency Alt-A residential            | 15,980            |                  | (5,950)           | 10,030     | (5,950)                     |
| Total mortgage-backed securities        | 290,364           | 6,003            | (6,235)           | 290,132    | (5,950)                     |
| Equity securities                       | 419               | 206              | (104)             | 521        |                             |
| Total                                   | \$ 491,615        | \$ 12,559        | \$ (21,744)       | \$ 482,430 | \$ (5,950)                  |

(1) Other-than-temporary impairment in accumulated other comprehensive income

The amortized cost and estimated fair value of held-to-maturity securities, including gross unrealized gains and losses, at June 30, 2012, and December 31, 2011, were as follows:

| (Amounts in thousands) | June 30, 2012  |                  |                   |            |
|------------------------|----------------|------------------|-------------------|------------|
|                        | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Municipal securities   | \$ 1,295       | \$ 24            | \$ (1)            | \$ 1,318   |
| Total                  | \$ 1,295       | \$ 24            | \$ (1)            | \$ 1,318   |

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| <i>(Amounts in thousands)</i> | December 31, 2011 |                     |                      | Fair<br>Value |
|-------------------------------|-------------------|---------------------|----------------------|---------------|
|                               | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses |               |
| Municipal securities          | \$ 3,490          | \$ 42               | \$                   | \$ 3,532      |
| Total                         | \$ 3,490          | \$ 42               | \$                   | \$ 3,532      |

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The amortized cost and estimated fair value of available-for-sale and held-to-maturity securities by contractual maturity at June 30, 2012, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| <i>(Amounts in thousands)</i>             | <b>Amortized<br/>Cost</b> | <b>Fair<br/>Value</b> |
|-------------------------------------------|---------------------------|-----------------------|
| Available-for-sale securities             |                           |                       |
| Due within one year                       | \$ 14,646                 | \$ 14,657             |
| Due after one year but within five years  | 17,311                    | 17,978                |
| Due after five years but within ten years | 19,262                    | 20,238                |
| Due after ten years                       | 162,939                   | 157,174               |
|                                           | 214,158                   | 210,047               |
| Mortgage-backed securities                | 315,569                   | 316,015               |
| Equity securities                         | 419                       | 545                   |
| <b>Total</b>                              | <b>\$ 530,146</b>         | <b>\$ 526,607</b>     |
| Held-to-maturity securities               |                           |                       |
| Due within one year                       | \$ 430                    | \$ 434                |
| Due after one year but within five years  | 865                       | 884                   |
| Due after five years but within ten years |                           |                       |
| Due after ten years                       |                           |                       |
| <b>Total</b>                              | <b>\$ 1,295</b>           | <b>\$ 1,318</b>       |

Available-for-sale securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer at June 30, 2012, and December 31, 2011 were as follows:

| <i>(Amounts in thousands)</i>           | <b>Less than 12 Months</b> |                              | <b>June 30, 2012<br/>12 Months or longer</b> |                              | <b>Total</b>          |                              |
|-----------------------------------------|----------------------------|------------------------------|----------------------------------------------|------------------------------|-----------------------|------------------------------|
|                                         | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>                        | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| Municipal securities                    | \$ 12,610                  | \$ (198)                     | \$                                           | \$                           | \$ 12,610             | \$ (198)                     |
| Single issue trust preferred securities |                            |                              | 44,506                                       | (11,172)                     | 44,506                | (11,172)                     |
| Mortgage-backed securities:             |                            |                              |                                              |                              |                       |                              |
| Agency                                  | 52,932                     | (252)                        | 11,790                                       | (5)                          | 64,722                | (257)                        |
| Non-Agency Alt-A residential            |                            |                              | 9,925                                        | (5,607)                      | 9,925                 | (5,607)                      |
| Total mortgage-backed securities        | 52,932                     | (252)                        | 21,715                                       | (5,612)                      | 74,647                | (5,864)                      |
| Equity securities                       |                            |                              | 94                                           | (94)                         | 94                    | (94)                         |
| <b>Total</b>                            | <b>\$ 65,542</b>           | <b>\$ (450)</b>              | <b>\$ 66,315</b>                             | <b>\$ (16,878)</b>           | <b>\$ 131,857</b>     | <b>\$ (17,328)</b>           |

| <i>(Amounts in thousands)</i> | <b>Less than 12 Months</b> |                              | <b>December 31, 2011<br/>12 Months or longer</b> |                              | <b>Total</b>          |                              |
|-------------------------------|----------------------------|------------------------------|--------------------------------------------------|------------------------------|-----------------------|------------------------------|
|                               | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>                            | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| Municipal securities          | \$                         | \$                           | \$ 40,244                                        | \$ (15,405)                  | \$ 40,244             | \$ (15,405)                  |
| Mortgage-backed securities:   |                            |                              |                                                  |                              |                       |                              |
| Agency                        | 52,300                     | (285)                        |                                                  |                              | 52,300                | (285)                        |

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|                                  |           |          |           |             |            |             |
|----------------------------------|-----------|----------|-----------|-------------|------------|-------------|
| Non-Agency Alt-A residential     |           |          | 10,030    | (5,950)     | 10,030     | (5,950)     |
| Total mortgage-backed securities | 52,300    | (285)    | 10,030    | (5,950)     | 62,330     | (6,235)     |
| Equity securities                |           |          | 188       | (104)       | 188        | (104)       |
| Total                            | \$ 52,300 | \$ (285) | \$ 50,462 | \$ (21,459) | \$ 102,762 | \$ (21,744) |

There were no held-to-maturity securities in a continuous unrealized loss position at June 30, 2012, or December 31, 2011. The carrying value of securities pledged to secure public deposits and for other purposes was \$295.37 million and \$288.80 million at June 30, 2012, and December 31, 2011, respectively.

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The following table details the Company's gross gains and gross losses realized from the sale of securities for the three and six months ended June 30, 2012 and 2011.

| <i>(Amounts in thousands)</i>                | <b>Three Months Ended<br/>June 30,</b> |                 | <b>Six Months Ended<br/>June 30,</b> |                 |
|----------------------------------------------|----------------------------------------|-----------------|--------------------------------------|-----------------|
|                                              | <b>2012</b>                            | <b>2011</b>     | <b>2012</b>                          | <b>2011</b>     |
| Gross realized gains                         | \$ 30                                  | \$ 4,325        | \$ 119                               | \$ 6,681        |
| Gross realized losses                        | (39)                                   | (1,101)         | (77)                                 | (1,621)         |
| <b>Net (loss) gain on sale of securities</b> | <b>\$ (9)</b>                          | <b>\$ 3,224</b> | <b>\$ 42</b>                         | <b>\$ 5,060</b> |

At June 30, 2012, the combined depreciation in value of 58 individual securities in an unrealized loss position was 3.31% of the combined reported value of the aggregate securities portfolio. At December 31, 2011, the combined depreciation in value of 28 individual securities in an unrealized loss position was 4.51% of the combined reported value of the aggregate securities portfolio.

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

For nonbeneficial interest debt securities, the Company analyzes several qualitative factors such as the severity and duration of the impairment, adverse conditions within the issuing industry, prospects for the issuer, performance of the security, changes in rating by rating agencies, and other qualitative factors to determine if the impairment will be recovered. Nonbeneficial interest debt securities consist of U.S. treasury securities, states and political subdivisions, and single issue trust preferred securities. If it is determined that there is evidence that the impairment will not be recovered, the Company performs a present value calculation to determine the amount of impairment and records any credit-related OTTI through earnings and noncredit-related OTTI through OCI. During the three and six months ended June 30, 2012 and June 30, 2011, the Company incurred no OTTI charges related to nonbeneficial interest debt securities. Temporary impairment on these securities is primarily related to changes in interest rates, certain disruptions in the credit markets, destabilization in the Eurozone, and other current economic factors.

For beneficial interest debt securities, the Company reviews cash flow analyses on each applicable security to determine if an adverse change in cash flows expected to be collected has occurred. Beneficial interest debt securities consist of corporate FDIC insured securities and mortgage-backed securities ( MBS ). An adverse change in cash flows expected to be collected has occurred if the present value of cash flows previously projected is greater than the present value of cash flows projected at the current reporting date and less than the current book value. If an adverse change in cash flows is deemed to have occurred, then an OTTI has occurred. The Company then compares the present value of cash flows using the current yield for the current reporting period to the reference amount, or current net book value, to determine the credit-related OTTI. The credit-related OTTI is then recorded through earnings and the noncredit-related OTTI is accounted for in OCI. During the three and six months ended June 30, 2012, the Company incurred no credit-related OTTI charges on beneficial interest debt securities. During the three months ended June 30, 2011, the Company incurred no credit-related OTTI charges related to beneficial interest debt securities. During the six months ended June 30, 2011, the Company incurred credit-related OTTI charges on beneficial interest debt securities of \$527 thousand related to a non-Agency MBS.

For the non-Agency Alt-A residential MBS, the Company uses a discounted cash flow model with the following assumptions: voluntary constant prepayment rate of 5%, a customized constant default rate scenario that assumes approximately 18% of the remaining underlying mortgages will default within three years, and a customized loss severity rate scenario that ramps the loss rate down from 60% to 15% over the course of 5 years.

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

| <i>(Amounts in thousands)</i>                                             | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|---------------------------------------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                                                           | <b>June 30,</b>           | <b>June 30,</b> | <b>June 30,</b>         | <b>June 30,</b> |
|                                                                           | <b>2012</b>               | <b>2011</b>     | <b>2012</b>             | <b>2011</b>     |
| Beginning balance <sup>(1)</sup>                                          | \$ 6,536                  | \$ 4,778        | \$ 6,536                | \$ 4,251        |
| Additions for credit losses on securities not previously recognized       |                           |                 |                         |                 |
| Additions for credit losses on securities previously recognized           |                           |                 |                         | 527             |
| Reduction for increases in cash flows                                     |                           |                 |                         |                 |
| Reduction for securities management no longer intends to hold to recovery |                           |                 |                         |                 |
| Reduction for securities sold/realized losses                             |                           |                 |                         |                 |
| Ending balance                                                            | \$ 6,536                  | \$ 4,778        | \$ 6,536                | \$ 4,778        |

(1) The beginning balance includes credit related losses included in OTTI charges recognized on debt securities in prior periods. For equity securities, the Company reviews for OTTI based upon the prospects of the underlying companies, analysts' expectations, and certain other qualitative factors to determine if impairment is recoverable over a foreseeable period of time. During the three and six months ended June 30, 2012 and 2011, the Company recognized no OTTI charges on equity securities.

As a condition to membership in the Federal Home Loan Bank ( FHLB ) and Federal Reserve Bank ( FRB ) systems, the Company is required to subscribe to a minimum level of stock in the FHLB of Atlanta ( FHLBA ) and FRB of Richmond ( FRB Richmond ). The Company feels this ownership position provides access to relatively inexpensive wholesale and overnight funding. FHLBA and FRB Richmond stock are reported as long-term investments in Other assets on the Company's Condensed Consolidated Balance Sheets. At June 30, 2012, and December 31, 2011, the Company owned \$12.78 million and \$10.82 million, respectively, of FHLBA stock. The Company's policy is to review the stock for impairment at each reporting period. During the first half of 2012, the FHLBA paid quarterly dividends and repurchased excess activity-based stock. Based on the Company's review and publicly available information concerning the FHLBA, it believes that as of June 30, 2012, its FHLBA stock was not impaired. At June 30, 2012, and December 31, 2011, the Company owned \$5.69 and \$4.78 million, respectively, of FRB Richmond stock.

**Table of Contents****Note 5. Loans*****Loan Portfolio***

Loans, net of unearned income, consisted of the following at June 30, 2012, and December 31, 2011:

| <i>(Amounts in thousands)</i>                           | <b>June 30, 2012</b> |                | <b>December 31, 2011</b> |                |
|---------------------------------------------------------|----------------------|----------------|--------------------------|----------------|
|                                                         | <b>Amount</b>        | <b>Percent</b> | <b>Amount</b>            | <b>Percent</b> |
| Covered loans                                           | \$ 238,777           | 13.21%         | \$                       | 0.00%          |
| Non-covered loans                                       |                      |                |                          |                |
| Commercial loans                                        |                      |                |                          |                |
| Construction commercial                                 | 20,877               | 1.16%          | 35,482                   | 2.54%          |
| Land development                                        | 6,549                | 0.36%          | 2,902                    | 0.21%          |
| Other land loans                                        | 26,571               | 1.47%          | 23,384                   | 1.67%          |
| Commercial and industrial                               | 99,364               | 5.50%          | 91,939                   | 6.58%          |
| Multi-family residential                                | 86,040               | 4.76%          | 77,050                   | 5.52%          |
| Single family non-owner occupied                        | 140,684              | 7.79%          | 106,743                  | 7.65%          |
| Non-farm, non-residential                               | 453,820              | 25.12%         | 336,005                  | 24.07%         |
| Agricultural                                            | 1,643                | 0.09%          | 1,374                    | 0.10%          |
| Farmland                                                | 38,423               | 2.13%          | 37,161                   | 2.66%          |
| Total commercial loans                                  | 873,971              | 48.38%         | 712,040                  | 51.00%         |
| Consumer real estate loans                              |                      |                |                          |                |
| Home equity lines                                       | 115,843              | 6.41%          | 111,387                  | 7.98%          |
| Single family owner occupied                            | 466,450              | 25.81%         | 473,067                  | 33.89%         |
| Owner occupied construction                             | 30,417               | 1.68%          | 19,577                   | 1.40%          |
| Total consumer real estate loans                        | 612,710              | 33.90%         | 604,031                  | 43.27%         |
| Consumer and other loans                                |                      |                |                          |                |
| Consumer loans                                          | 75,781               | 4.19%          | 67,129                   | 4.81%          |
| Other                                                   | 5,850                | 0.32%          | 12,867                   | 0.92%          |
| Total consumer and other loans                          | 81,631               | 4.51%          | 79,996                   | 5.73%          |
| Total non-covered loans                                 | 1,568,312            | 86.79%         | 1,396,067                | 100.00%        |
| Total loans held for investment, net of unearned income | \$ 1,807,089         | 100.00%        | \$ 1,396,067             | 100.00%        |
| Loans held for sale                                     | \$ 1,179             |                | \$ 5,820                 |                |

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Covered loans held for investment, net of unearned income, consisted of the following at June 30, 2012.

| <i>(Amounts in thousands)</i>    | <b>June 30, 2012</b> |
|----------------------------------|----------------------|
| Covered loans                    |                      |
| Commercial loans                 |                      |
| Construction commercial          | \$ 17,770            |
| Land development                 |                      |
| Other land loans                 |                      |
| Commercial and industrial        | 7,663                |
| Multi-family residential         | 3,706                |
| Single family non-owner occupied |                      |
| Non-farm, non-residential        | 66,751               |
| Agricultural                     | 307                  |
| Farmland                         | 1,345                |
| Total commercial loans           | 97,542               |
| Consumer real estate loans       |                      |
| Home equity lines                | 88,508               |
| Single family owner occupied     | 45,691               |
| Owner occupied construction      | 2,502                |
| Total consumer real estate loans | 136,701              |
| Consumer and other loans         |                      |
| Consumer loans                   | 4,534                |
| Other                            |                      |
| Total consumer and other loans   | 4,534                |
| Total covered loans              | \$ 238,777           |

See Note 11, Commitments and Contingencies, for information concerning the Company's off-balance sheet credit risk related to lending activities.

**Acquired Impaired Loans**

The following table presents the carrying balance of acquired impaired loans and activity within those loans during the periods indicated. The Company has estimated the cash flows to be collected on the loans and discounted those cash flows at a market rate of interest. As previously discussed in Note 3, Business Combinations, the Company is in the process of identifying the purchased performing and credit impaired loans from the Peoples and Waccamaw acquisitions; therefore, acquisitions completed during the second quarter of 2012 are not reflected in the following tables.

| <i>(Amounts in thousands)</i> | <b>Six Months Ended June 30,</b> |             |
|-------------------------------|----------------------------------|-------------|
|                               | <b>2012</b>                      | <b>2011</b> |
| Balance, January 1            | \$ 2,886                         | \$ 3,221    |
| Accretion                     | 1,146                            | 13          |
| Principal payments received   | (1,739)                          | (173)       |
| Other                         | 4                                | 60          |
| Charge-offs                   | (4)                              |             |
| Balance, June 30              | \$ 2,293                         | \$ 3,121    |

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The outstanding balance of acquired impaired loans, excluding the Peoples and Waccamaw portfolios, was \$5.98 million at June 30, 2012, \$7.71 million at December 31, 2011, and \$8.45 million at June 30, 2011.

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The following table presents changes in the accretable yield during the periods indicated:

| (Amounts in thousands)                          | Six Months Ended June 30, |        |
|-------------------------------------------------|---------------------------|--------|
|                                                 | 2012                      | 2011   |
| Balance, January 1                              | \$ 919                    | \$ 944 |
| Accretion                                       | (1,146)                   | (13)   |
| Reclassifications from nonaccretable difference | 92                        |        |
| Disposals                                       | 161                       |        |
| Balance, June 30                                | \$ 26                     | \$ 931 |

**Note 6. Allowance for Loan Losses and Credit Quality Indicators****Allowance for Loan Losses**

The allowance for loan losses is maintained at a level management deems sufficient to absorb probable loan losses inherent in the loan portfolio. The allowance is increased by charges to earnings in the form of provision for loan losses and recoveries of prior loan charge-offs, and decreased by loans charged off. The provision is calculated to bring the allowance to a level which, according to a systematic process of measurement, reflects the amount management estimates is needed to absorb probable losses within the portfolio. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities toward loan classifications. Purchased credit impaired loan pools are evaluated separately from the non-purchased credit impaired portfolio for impairment. See Note 3, Business Combinations, for additional information.

Management performs quarterly assessments to determine the appropriate level of allowance for loan losses. Differences between actual loan loss experience and estimates are reflected through adjustments that are made by increasing or decreasing the allowance based upon current measurement criteria. Commercial, consumer real estate, and non-real estate consumer loan portfolios are evaluated separately for purposes of determining the allowance. The specific components of the allowance include allocations to individual commercial loans and credit relationships and allocations to the remaining nonhomogeneous and homogeneous pools of loans that have been deemed impaired. Additionally, a loan that becomes adversely classified or graded is removed from a group of loans with similar risk characteristics that are not classified or graded to evaluate the removed loan collectively in a group of adversely classified or graded loans with similar risk characteristics. Management's general reserve allocations are based on judgment of qualitative and quantitative factors about macro and micro economic conditions reflected within the portfolio of loans and the economy as a whole. Factors considered in this evaluation include, but are not necessarily limited to, probable losses from loan and other credit arrangements, general economic conditions, changes in credit concentrations or pledged collateral, historical loan loss experience, and trends in portfolio volume, maturities, composition, delinquencies, and nonaccruals. Historical loss rates for each risk grade of commercial loans are adjusted by environmental factors to estimate the amount of reserve needed by segment. While management has allocated the allowance for loan losses to various portfolio segments, the entire allowance is available for use against any type of loan loss deemed appropriate by management.

The following tables detail activity within the allowance for loan losses, by portfolio segment, for the three and six months ended June 30, 2012 and 2011.

| (Amounts in thousands)           | Three Months Ended June 30, 2012 |                      |                    |           | Three Months Ended June 30, 2011 |                      |                    |           |
|----------------------------------|----------------------------------|----------------------|--------------------|-----------|----------------------------------|----------------------|--------------------|-----------|
|                                  | Commercial                       | Consumer Real Estate | Consumer and Other | Total     | Commercial                       | Consumer Real Estate | Consumer and Other | Total     |
| Beginning balance                | \$ 17,865                        | \$ 7,259             | \$ 676             | \$ 25,800 | \$ 12,300                        | \$ 12,641            | \$ 1,541           | \$ 26,482 |
| Provision for loan losses        | 950                              | 623                  | 47                 | 1,620     | 2,504                            | 408                  | 167                | 3,079     |
| Loans charged off                | (836)                            | (619)                | (157)              | (1,612)   | (2,727)                          | (457)                | (272)              | (3,456)   |
| Recoveries credited to allowance | 278                              | 9                    | 76                 | 363       | 223                              | 49                   | 105                | 377       |
| Net charge-offs                  | (558)                            | (610)                | (81)               | (1,249)   | (2,504)                          | (408)                | (167)              | (3,079)   |

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|                |           |          |        |           |           |           |          |           |
|----------------|-----------|----------|--------|-----------|-----------|-----------|----------|-----------|
| Ending balance | \$ 18,257 | \$ 7,272 | \$ 642 | \$ 26,171 | \$ 12,300 | \$ 12,641 | \$ 1,541 | \$ 26,482 |
|----------------|-----------|----------|--------|-----------|-----------|-----------|----------|-----------|

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|                                  | Six Months Ended June 30, 2012 |                      |                    |           | Six Months Ended June 30, 2011 |                      |                    |           |
|----------------------------------|--------------------------------|----------------------|--------------------|-----------|--------------------------------|----------------------|--------------------|-----------|
|                                  | Commercial                     | Consumer Real Estate | Consumer and Other | Total     | Commercial                     | Consumer Real Estate | Consumer and Other | Total     |
| <i>(Amounts in thousands)</i>    |                                |                      |                    |           |                                |                      |                    |           |
| Beginning balance                | \$ 17,752                      | \$ 7,711             | \$ 742             | \$ 26,205 | \$ 12,300                      | \$ 12,641            | \$ 1,541           | \$ 26,482 |
| Provision for loan losses        | 1,216                          | 1,237                | 89                 | 2,542     | 2,865                          | 1,621                | 205                | 4,691     |
| Loans charged off                | (1,086)                        | (1,727)              | (361)              | (3,174)   | (3,167)                        | (1,829)              | (487)              | (5,483)   |
| Recoveries credited to allowance | 375                            | 51                   | 172                | 598       | 302                            | 208                  | 282                | 792       |
| Net charge-offs                  | (711)                          | (1,676)              | (189)              | (2,576)   | (2,865)                        | (1,621)              | (205)              | (4,691)   |
| Ending balance                   | \$ 18,257                      | \$ 7,272             | \$ 642             | \$ 26,171 | \$ 12,300                      | \$ 12,641            | \$ 1,541           | \$ 26,482 |

**Credit Quality Indicators**

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

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The following tables present the Company's recorded investment in non-purchased loans considered to be impaired and related information on those impaired loans for the periods indicated:

|                                           | June 30, 2012          |                                |                      | December 31, 2011      |                                |                      |
|-------------------------------------------|------------------------|--------------------------------|----------------------|------------------------|--------------------------------|----------------------|
|                                           | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| <i>(Amounts in thousands)</i>             |                        |                                |                      |                        |                                |                      |
| Impaired loans with no related allowance: |                        |                                |                      |                        |                                |                      |
| Commercial loans                          |                        |                                |                      |                        |                                |                      |
| Construction commercial                   | \$ 12                  | \$ 12                          | \$                   | \$ 411                 | \$ 411                         | \$                   |
| Land development                          |                        |                                |                      | 250                    | 250                            |                      |
| Other land loans                          |                        |                                |                      |                        |                                |                      |
| Commercial and industrial                 | 61                     | 66                             |                      | 114                    | 127                            |                      |
| Multi-family residential                  | 796                    | 801                            |                      | 278                    | 278                            |                      |
| Single family non-owner occupied          | 1,202                  | 1,248                          |                      | 1,206                  | 1,244                          |                      |
| Non-farm, non-residential                 | 816                    | 856                            |                      | 1,616                  | 1,647                          |                      |
| Agricultural                              |                        |                                |                      |                        |                                |                      |
| Farmland                                  |                        |                                |                      | 258                    | 258                            |                      |
| Consumer real estate loans                |                        |                                |                      |                        |                                |                      |
| Home equity lines                         | 366                    | 385                            |                      | 368                    | 378                            |                      |
| Single family owner occupied              | 5,812                  | 5,926                          |                      | 2,428                  | 2,508                          |                      |
| Owner occupied construction               |                        |                                |                      |                        |                                |                      |
| Consumer and other loans                  |                        |                                |                      |                        |                                |                      |
| Consumer loans                            |                        |                                |                      | 6                      | 6                              |                      |
| Total impaired loans with no allowance    | 9,065                  | 9,294                          |                      | 6,935                  | 7,107                          |                      |
| Impaired loans with a related allowance:  |                        |                                |                      |                        |                                |                      |
| Commercial loans                          |                        |                                |                      |                        |                                |                      |
| Construction commercial                   |                        |                                |                      |                        |                                |                      |
| Land development                          |                        |                                |                      |                        |                                |                      |
| Other land loans                          | 111                    | 111                            | 4                    | 112                    | 112                            | 4                    |
| Commercial and industrial                 | 3,914                  | 3,936                          | 3,739                | 4,031                  | 4,069                          | 2,048                |
| Multi-family residential                  |                        |                                |                      |                        |                                |                      |
| Single family non-owner occupied          | 2,895                  | 2,914                          | 441                  | 2,232                  | 2,232                          | 124                  |
| Non-farm, non-residential                 | 6,620                  | 6,966                          | 1,647                | 5,317                  | 5,480                          | 1,819                |
| Agricultural                              |                        |                                |                      |                        |                                |                      |
| Farmland                                  |                        |                                |                      |                        |                                |                      |
| Consumer real estate loans                |                        |                                |                      |                        |                                |                      |
| Home equity lines                         | 250                    | 250                            | 250                  |                        |                                |                      |
| Single family owner occupied              | 2,586                  | 2,686                          | 710                  | 5,529                  | 5,612                          | 1,203                |
| Owner occupied construction               |                        |                                |                      |                        |                                |                      |
| Consumer and other loans                  |                        |                                |                      |                        |                                |                      |
| Consumer loans                            |                        |                                |                      |                        |                                |                      |
| Total impaired loans with an allowance    | 16,376                 | 16,863                         | 6,791                | 17,221                 | 17,505                         | 5,198                |
| Total impaired loans                      | \$ 25,441              | \$ 26,157                      | \$ 6,791             | \$ 24,156              | \$ 24,612                      | \$ 5,198             |

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|                                           | For the Three Months Ended<br>June 30, 2012 |                                  | For the Six Months Ended<br>June 30, 2012 |                                  |
|-------------------------------------------|---------------------------------------------|----------------------------------|-------------------------------------------|----------------------------------|
|                                           | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized |
| <i>(Amounts in thousands)</i>             |                                             |                                  |                                           |                                  |
| Impaired loans with no related allowance: |                                             |                                  |                                           |                                  |
| Commercial loans                          |                                             |                                  |                                           |                                  |
| Construction commercial                   | \$ 11                                       | \$                               | \$ 30                                     | \$                               |
| Land development                          |                                             |                                  |                                           |                                  |
| Other land loans                          |                                             |                                  |                                           |                                  |
| Commercial and industrial                 | 67                                          | 5                                | 77                                        | 5                                |
| Multi-family residential                  | 879                                         | 4                                | 1,196                                     | 4                                |
| Single family non-owner occupied          | 1,405                                       | 8                                | 1,813                                     | 17                               |
| Non-farm, non-residential                 | 886                                         | 7                                | 1,119                                     | 17                               |
| Agricultural                              |                                             |                                  |                                           |                                  |
| Farmland                                  |                                             |                                  |                                           |                                  |
| Consumer real estate loans                |                                             |                                  |                                           |                                  |
| Home equity lines                         | 378                                         | 8                                | 503                                       | 14                               |
| Single family owner occupied              | 5,842                                       | 27                               | 7,155                                     | 48                               |
| Owner occupied construction               |                                             |                                  |                                           |                                  |
| Consumer and other loans                  |                                             |                                  |                                           |                                  |
| Consumer loans                            |                                             |                                  |                                           |                                  |
| Total impaired loans with no allowance    | 9,468                                       | 59                               | 11,893                                    | 105                              |
| Impaired loans with a related allowance:  |                                             |                                  |                                           |                                  |
| Commercial loans                          |                                             |                                  |                                           |                                  |
| Construction commercial                   |                                             |                                  |                                           |                                  |
| Land development                          |                                             |                                  |                                           |                                  |
| Other land loans                          | 111                                         |                                  | 111                                       | 1                                |
| Commercial and industrial                 | 3,922                                       | 72                               | 3,973                                     | 72                               |
| Multi-family residential                  |                                             |                                  |                                           |                                  |
| Single family non-owner occupied          | 2,888                                       | 11                               | 2,910                                     | 42                               |
| Non-farm, non-residential                 | 6,683                                       | 145                              | 6,952                                     | 236                              |
| Agricultural                              |                                             |                                  |                                           |                                  |
| Farmland                                  |                                             |                                  |                                           |                                  |
| Consumer real estate loans                |                                             |                                  |                                           |                                  |
| Home equity lines                         | 250                                         |                                  | 250                                       |                                  |
| Single family owner occupied              | 2,581                                       | 28                               | 2,697                                     | 53                               |
| Owner occupied construction               |                                             |                                  |                                           |                                  |
| Consumer and other loans                  |                                             |                                  |                                           |                                  |
| Consumer loans                            |                                             |                                  |                                           |                                  |
| Total impaired loans with an allowance    | 16,435                                      | 256                              | 16,893                                    | 404                              |
| Total impaired loans                      | \$ 25,903                                   | \$ 315                           | \$ 28,786                                 | \$ 509                           |

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|                                           | For the Three Months Ended<br>June 30, 2011 |                                  | For the Six Months Ended<br>June 30, 2011 |                                  |
|-------------------------------------------|---------------------------------------------|----------------------------------|-------------------------------------------|----------------------------------|
|                                           | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized |
| <i>(Amounts in thousands)</i>             |                                             |                                  |                                           |                                  |
| Impaired loans with no related allowance: |                                             |                                  |                                           |                                  |
| Commercial loans                          |                                             |                                  |                                           |                                  |
| Construction commercial                   | \$ 481                                      | \$                               | \$ 322                                    | \$                               |
| Land development                          | 916                                         |                                  | 458                                       |                                  |
| Other land loans                          | 2,291                                       |                                  | 1,491                                     | 1                                |
| Commercial and industrial                 | 4,015                                       |                                  | 4,097                                     |                                  |
| Multi-family residential                  | 1,357                                       | 1                                | 1,578                                     | 14                               |
| Single family non-owner occupied          | 1,158                                       | 19                               | 1,263                                     | 19                               |
| Non-farm, non-residential                 | 1,676                                       | 10                               | 2,322                                     | 10                               |
| Agricultural                              |                                             |                                  |                                           |                                  |
| Farmland                                  |                                             |                                  |                                           |                                  |
| Consumer real estate loans                |                                             |                                  |                                           |                                  |
| Home equity lines                         | 644                                         | 5                                | 506                                       | 8                                |
| Single family owner occupied              | 1,479                                       | 6                                | 1,250                                     | 5                                |
| Owner occupied construction               | 241                                         | 3                                | 121                                       | 3                                |
| Consumer and other loans                  |                                             |                                  |                                           |                                  |
| Consumer loans                            |                                             |                                  | 3                                         |                                  |
| Total impaired loans with no allowance    | 14,258                                      | 44                               | 13,411                                    | 60                               |
| Impaired loans with a related allowance:  |                                             |                                  |                                           |                                  |
| Commercial loans                          |                                             |                                  |                                           |                                  |
| Construction commercial                   | 269                                         |                                  | 135                                       |                                  |
| Land development                          |                                             |                                  |                                           |                                  |
| Other land loans                          | 113                                         | 2                                | 113                                       | 3                                |
| Commercial and industrial                 | 651                                         | 8                                | 651                                       | 8                                |
| Multi-family residential                  | 786                                         |                                  | 644                                       |                                  |
| Single family non-owner occupied          | 2,263                                       | 27                               | 2,389                                     | 54                               |
| Non-farm, non-residential                 | 3,052                                       | 8                                | 2,322                                     | 11                               |
| Agricultural                              |                                             |                                  |                                           |                                  |
| Farmland                                  | 333                                         |                                  | 166                                       |                                  |
| Consumer real estate loans                |                                             |                                  |                                           |                                  |
| Home equity lines                         |                                             |                                  | 49                                        |                                  |
| Single family owner occupied              | 6,079                                       | 56                               | 5,734                                     | 92                               |
| Owner occupied construction               |                                             |                                  |                                           |                                  |
| Consumer and other loans                  |                                             |                                  |                                           |                                  |
| Consumer loans                            |                                             |                                  |                                           |                                  |
| Total impaired loans with an allowance    | 13,546                                      | 101                              | 12,203                                    | 168                              |
| Total impaired loans                      | \$ 27,804                                   | \$ 145                           | \$ 25,614                                 | \$ 228                           |

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The following tables detail the Company's recorded investment in loans related to each segment in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology at June 30, 2012, and December 31, 2011. The Company is still in the process of identifying purchased performing and credit impaired loans from the Peoples and Waccamaw acquisitions; therefore, those acquired loans have been excluded from the table below.

|                                  | June 30, 2012                                                        |                                                     |                                                      |                                                     |                                                              |                                                          |
|----------------------------------|----------------------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|-----------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------------|
|                                  | Non-acquired<br>Loans Individually<br>Evaluated<br>for<br>Impairment | Allowance<br>for Loans<br>Individually<br>Evaluated | Loans<br>Collectively<br>Evaluated for<br>Impairment | Allowance<br>for Loans<br>Collectively<br>Evaluated | Acquired<br>Impaired Loans<br>Evaluated<br>for<br>Impairment | Allowance<br>for Acquired<br>Impaired Loans<br>Evaluated |
| <i>(Amounts in thousands)</i>    |                                                                      |                                                     |                                                      |                                                     |                                                              |                                                          |
| Commercial loans                 |                                                                      |                                                     |                                                      |                                                     |                                                              |                                                          |
| Construction commercial          | \$ 12                                                                | \$                                                  | \$ 13,298                                            | \$ 491                                              | \$                                                           | \$                                                       |
| Land development                 |                                                                      |                                                     | 6,549                                                | 136                                                 |                                                              |                                                          |
| Other land loans                 | 111                                                                  | 4                                                   | 26,460                                               | 346                                                 |                                                              |                                                          |
| Commercial and industrial        | 3,967                                                                | 3,731                                               | 75,236                                               | 1,333                                               | 255                                                          | 8                                                        |
| Multi-family residential         | 796                                                                  |                                                     | 80,010                                               | 2,163                                               |                                                              |                                                          |
| Single family non-owner occupied | 4,097                                                                | 441                                                 | 135,446                                              | 2,458                                               | 1,141                                                        |                                                          |
| Non-farm, non-residential        | 7,436                                                                | 1,647                                               | 350,269                                              | 5,105                                               | 483                                                          |                                                          |
| Agricultural                     |                                                                      |                                                     | 1,643                                                | 19                                                  |                                                              |                                                          |
| Farmland                         |                                                                      |                                                     | 37,211                                               | 375                                                 |                                                              |                                                          |
| Total commercial loans           | 16,419                                                               | 5,823                                               | 726,122                                              | 12,426                                              | 1,879                                                        | 8                                                        |
| Consumer real estate loans       |                                                                      |                                                     |                                                      |                                                     |                                                              |                                                          |
| Home equity lines                | 616                                                                  | 250                                                 | 107,236                                              | 1,277                                               |                                                              |                                                          |
| Single family owner occupied     | 8,398                                                                | 710                                                 | 427,321                                              | 4,849                                               | 414                                                          |                                                          |
| Owner occupied construction      |                                                                      |                                                     | 30,417                                               | 186                                                 |                                                              |                                                          |
| Total consumer real estate loans | 9,014                                                                | 960                                                 | 564,974                                              | 6,312                                               | 414                                                          |                                                          |
| Consumer and other loans         |                                                                      |                                                     |                                                      |                                                     |                                                              |                                                          |
| Consumer loans                   |                                                                      |                                                     | 67,643                                               | 642                                                 |                                                              |                                                          |
| Other                            |                                                                      |                                                     | 5,850                                                |                                                     |                                                              |                                                          |
| Total consumer and other loans   |                                                                      |                                                     | 73,493                                               | 642                                                 |                                                              |                                                          |
| Total loans                      | \$ 25,433                                                            | \$ 6,783                                            | \$ 1,364,589                                         | \$ 19,380                                           | \$ 2,293                                                     | \$ 8                                                     |

|                                  | December 31, 2011                                                    |                                                     |                                                      |                                                     |                                                              |                                                          |
|----------------------------------|----------------------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|-----------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------------|
|                                  | Non-acquired<br>Loans Individually<br>Evaluated<br>for<br>Impairment | Allowance<br>for Loans<br>Individually<br>Evaluated | Loans<br>Collectively<br>Evaluated for<br>Impairment | Allowance<br>for Loans<br>Collectively<br>Evaluated | Acquired<br>Impaired Loans<br>Evaluated<br>for<br>Impairment | Allowance<br>for Acquired<br>Impaired Loans<br>Evaluated |
| <i>(Amounts in thousands)</i>    |                                                                      |                                                     |                                                      |                                                     |                                                              |                                                          |
| Commercial loans                 |                                                                      |                                                     |                                                      |                                                     |                                                              |                                                          |
| Construction commercial          | \$ 411                                                               | \$                                                  | \$ 35,071                                            | \$ 865                                              | \$                                                           | \$                                                       |
| Land development                 | 250                                                                  |                                                     | 2,652                                                | 481                                                 |                                                              |                                                          |
| Other land loans                 | 112                                                                  | 4                                                   | 23,123                                               | 542                                                 | 149                                                          |                                                          |
| Commercial and industrial        | 3,738                                                                | 1,847                                               | 87,563                                               | 1,668                                               | 638                                                          | 201                                                      |
| Multi-family residential         | 278                                                                  |                                                     | 76,772                                               | 1,889                                               |                                                              |                                                          |
| Single family non-owner occupied | 3,438                                                                | 124                                                 | 102,063                                              | 2,836                                               | 1,242                                                        |                                                          |
| Non-farm, non-residential        | 6,933                                                                | 1,819                                               | 328,610                                              | 5,114                                               | 462                                                          |                                                          |
| Agricultural                     |                                                                      |                                                     | 1,374                                                | 19                                                  |                                                              |                                                          |
| Farmland                         | 258                                                                  |                                                     | 36,903                                               | 343                                                 |                                                              |                                                          |

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|                                  |           |          |              |           |          |        |
|----------------------------------|-----------|----------|--------------|-----------|----------|--------|
| Total commercial loans           | 15,418    | 3,794    | 694,131      | 13,757    | 2,491    | 201    |
| Consumer real estate loans       |           |          |              |           |          |        |
| Home equity lines                | 368       |          | 111,019      | 1,365     |          |        |
| Single family owner occupied     | 7,957     | 1,203    | 464,715      | 4,931     | 395      |        |
| Owner occupied construction      |           |          | 19,577       | 212       |          |        |
| Total consumer real estate loans | 8,325     | 1,203    | 595,311      | 6,508     | 395      |        |
| Consumer and other loans         |           |          |              |           |          |        |
| Consumer loans                   | 6         |          | 67,123       | 742       |          |        |
| Other                            |           |          | 12,867       |           |          |        |
| Total consumer and other loans   | 6         |          | 79,990       | 742       |          |        |
| Total loans                      | \$ 23,749 | \$ 4,997 | \$ 1,369,432 | \$ 21,007 | \$ 2,886 | \$ 201 |

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

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

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

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

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

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

**Loss** This grade includes loans that are to be charged off or charged down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. Loss is not intended to imply that the asset has no recovery or salvage value, but simply that it is not practical or desirable to defer writing off all or some portion of the loan, even though partial recovery may be realized in the future.

The following tables present the Company's investment in loans held for investment by internal credit grade indicator at June 30, 2012, and December 31, 2011. There were no covered loans at December 31, 2011.

| (Amounts in thousands)           | June 30, 2012 |                    |             |          |      |           |
|----------------------------------|---------------|--------------------|-------------|----------|------|-----------|
|                                  | Pass          | Special<br>Mention | Substandard | Doubtful | Loss | Total     |
| Non-covered loans                |               |                    |             |          |      |           |
| Commercial loans                 |               |                    |             |          |      |           |
| Construction commercial          | \$ 19,390     | \$ 149             | \$ 1,338    | \$       | \$   | \$ 20,877 |
| Land development                 | 6,377         |                    | 172         |          |      | 6,549     |
| Other land loans                 | 23,178        | 3,084              | 309         |          |      | 26,571    |
| Commercial and industrial        | 90,824        | 951                | 3,033       | 4,556    |      | 99,364    |
| Multi-family residential         | 81,808        | 1,420              | 2,812       |          |      | 86,040    |
| Single family non-owner occupied | 126,382       | 2,711              | 11,230      | 361      |      | 140,684   |
| Non-farm, non-residential        | 408,333       | 11,953             | 33,072      | 462      |      | 453,820   |
| Agricultural                     | 1,603         | 5                  | 35          |          |      | 1,643     |
| Farmland                         | 35,057        | 1,366              | 2,000       |          |      | 38,423    |
| Consumer real estate loans       |               |                    |             |          |      |           |
| Home equity lines                | 108,758       | 1,947              | 4,888       | 250      |      | 115,843   |
| Single family owner occupied     | 425,619       | 8,774              | 32,057      |          |      | 466,450   |
| Owner occupied construction      | 29,892        | 272                | 253         |          |      | 30,417    |
| Consumer and other loans         |               |                    |             |          |      |           |
| Consumer loans                   | 74,750        | 363                | 659         | 9        |      | 75,781    |

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|                         |              |           |           |          |              |
|-------------------------|--------------|-----------|-----------|----------|--------------|
| Other                   | 5,818        | 25        | 7         |          | 5,850        |
| Total non-covered loans | \$ 1,437,789 | \$ 33,020 | \$ 91,865 | \$ 5,638 | \$ 1,568,312 |

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| June 30, 2012                    |            |                    |             |          |      |            |
|----------------------------------|------------|--------------------|-------------|----------|------|------------|
| (Amounts in thousands)           | Pass       | Special<br>Mention | Substandard | Doubtful | Loss | Total      |
| Covered loans                    |            |                    |             |          |      |            |
| Commercial loans                 |            |                    |             |          |      |            |
| Construction commercial          | \$ 3,818   | \$ 2,536           | \$ 11,319   | \$ 97    | \$   | \$ 17,770  |
| Land development                 |            |                    |             |          |      |            |
| Other land loans                 |            |                    |             |          |      |            |
| Commercial and industrial        | 6,986      | 204                | 279         | 194      |      | 7,663      |
| Multi-family residential         | 2,432      |                    | 1,274       |          |      | 3,706      |
| Single family non-owner occupied |            |                    |             |          |      |            |
| Non-farm, non-residential        | 41,419     | 6,565              | 18,724      | 43       |      | 66,751     |
| Agricultural                     | 305        |                    | 2           |          |      | 307        |
| Farmland                         | 1,102      | 1                  | 242         |          |      | 1,345      |
| Consumer real estate loans       |            |                    |             |          |      |            |
| Home equity lines                | 86,685     | 990                | 808         | 25       |      | 88,508     |
| Single family owner occupied     | 33,234     | 4,552              | 7,522       | 383      |      | 45,691     |
| Owner occupied construction      | 1,218      | 283                | 985         | 16       |      | 2,502      |
| Consumer and other loans         |            |                    |             |          |      |            |
| Consumer loans                   | 3,740      | 575                | 154         | 65       |      | 4,534      |
| Other                            |            |                    |             |          |      |            |
| Total covered loans              | \$ 180,939 | \$ 15,706          | \$ 41,309   | \$ 823   | \$   | \$ 238,777 |

| December 31, 2011                |              |                    |             |          |      |              |
|----------------------------------|--------------|--------------------|-------------|----------|------|--------------|
| (Amounts in thousands)           | Pass         | Special<br>Mention | Substandard | Doubtful | Loss | Total        |
| Commercial loans                 |              |                    |             |          |      |              |
| Construction commercial          | \$ 34,512    | \$ 15              | \$ 955      | \$       | \$   | \$ 35,482    |
| Land development                 | 2,479        |                    | 423         |          |      | 2,902        |
| Other land loans                 | 17,171       | 5,629              | 584         |          |      | 23,384       |
| Commercial and industrial        | 86,288       | 568                | 2,679       | 2,404    |      | 91,939       |
| Multi-family residential         | 74,486       | 965                | 1,599       |          |      | 77,050       |
| Single family non-owner occupied | 93,444       | 1,346              | 11,953      |          |      | 106,743      |
| Non-farm, non-residential        | 303,071      | 9,635              | 22,855      | 444      |      | 336,005      |
| Agricultural                     | 1,327        | 7                  | 40          |          |      | 1,374        |
| Farmland                         | 35,568       | 1,055              | 538         |          |      | 37,161       |
| Consumer real estate loans       |              |                    |             |          |      |              |
| Home equity lines                | 105,535      | 2,237              | 3,615       |          |      | 111,387      |
| Single family owner occupied     | 435,001      | 8,936              | 29,130      |          |      | 473,067      |
| Owner occupied construction      | 19,190       | 128                | 259         |          |      | 19,577       |
| Consumer and other loans         |              |                    |             |          |      |              |
| Consumer loans                   | 66,357       | 198                | 574         |          |      | 67,129       |
| Other                            | 12,857       | 1                  | 9           |          |      | 12,867       |
| Total loans                      | \$ 1,287,286 | \$ 30,720          | \$ 75,213   | \$ 2,848 | \$   | \$ 1,396,067 |

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Nonaccrual loans, presented by loan class, consisted of the following at June 30, 2012, and December 31, 2011. Loans acquired through business combinations, for which a discount exists, are not considered to be nonaccrual as a result of the accretion of the discount based on the expected cash flow of the loans.

| <i>(Amounts in thousands)</i>    | <b>June 30, 2012</b> | <b>December 31, 2011</b> |
|----------------------------------|----------------------|--------------------------|
| <b>Commercial loans</b>          |                      |                          |
| Construction commercial          | \$ 182               | \$ 461                   |
| Land development                 | 48                   | 297                      |
| Other land loans                 | 216                  | 35                       |
| Commercial and industrial        | 4,402                | 3,905                    |
| Multi-family residential         | 796                  | 341                      |
| Single family non-owner occupied | 4,355                | 1,639                    |
| Non-farm, non-residential        | 8,655                | 8,063                    |
| Farmland                         | 100                  | 271                      |
| Consumer real estate loans       |                      |                          |
| Home equity lines                | 670                  | 516                      |
| Single family owner occupied     | 8,427                | 8,255                    |
| Owner occupied construction      | 33                   | 1                        |
| Consumer and other loans         |                      |                          |
| Consumer loans                   | 55                   | 52                       |
| <br>Total                        | <br>27,939           | <br>23,836               |
| Acquired impaired loans          | 8                    | 651                      |
| <br>Total nonaccrual loans       | <br>\$ 27,947        | <br>\$ 24,487            |

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The following tables present the aging of past due loans, by loan class, at June 30, 2012, and December 31, 2011. Nonaccrual loans, excluding those 0 to 29 days past due, are included in the applicable delinquency category. There were no accruing loans contractually past due 90 days or more at June 30, 2012, or December 31, 2011. Acquired loans that are past due continue to accrue accretable yield under the accretion method of accounting and therefore are not considered to be nonaccrual. As a result of the Company being in the process of identifying the purchased performing and credit impaired loans from the Peoples and Waccamaw acquisition, all loans from the acquisitions are included in the applicable delinquency category.

|                                  | June 30, 2012               |                          |                      |                   |                  |                |
|----------------------------------|-----------------------------|--------------------------|----------------------|-------------------|------------------|----------------|
|                                  | 30 - 59 Days<br>Past<br>Due | 60 - 89 Days<br>Past Due | 90+ Days<br>Past Due | Total<br>Past Due | Current<br>Loans | Total<br>Loans |
| (Amounts in thousands)           |                             |                          |                      |                   |                  |                |
| Non-covered loans                |                             |                          |                      |                   |                  |                |
| Commercial loans                 |                             |                          |                      |                   |                  |                |
| Construction commercial          | \$ 347                      | \$ 72                    | \$ 1,188             | \$ 1,607          | \$ 19,270        | \$ 20,877      |
| Land development                 |                             |                          | 48                   | 48                | 6,501            | 6,549          |
| Other land loans                 | 65                          |                          | 216                  | 281               | 26,290           | 26,571         |
| Commercial and industrial        | 1,069                       | 101                      | 1,316                | 2,486             | 96,878           | 99,364         |
| Multi-family residential         | 751                         | 476                      | 401                  | 1,628             | 84,412           | 86,040         |
| Single family non-owner occupied | 674                         | 404                      | 3,306                | 4,384             | 136,300          | 140,684        |
| Non-farm, non-residential        | 2,038                       | 670                      | 5,794                | 8,502             | 445,318          | 453,820        |
| Agricultural                     | 34                          |                          |                      | 34                | 1,609            | 1,643          |
| Farmland                         | 313                         |                          |                      | 313               | 38,110           | 38,423         |
| Consumer real estate loans       |                             |                          |                      |                   |                  |                |
| Home equity lines                | 1,148                       | 468                      | 461                  | 2,077             | 113,766          | 115,843        |
| Single family owner occupied     | 2,784                       | 727                      | 5,146                | 8,657             | 457,793          | 466,450        |
| Owner occupied construction      | 19                          | 129                      | 33                   | 181               | 30,236           | 30,417         |
| Consumer and other loans         |                             |                          |                      |                   |                  |                |
| Consumer loans                   | 296                         | 21                       | 36                   | 353               | 75,428           | 75,781         |
| Other                            |                             |                          |                      |                   | 5,850            | 5,850          |
| Total non-covered loans          | \$ 9,538                    | \$ 3,068                 | \$ 17,945            | \$ 30,551         | \$ 1,537,761     | \$ 1,568,312   |

|                                  | June 30, 2012               |                          |                      |                   |                  |                |
|----------------------------------|-----------------------------|--------------------------|----------------------|-------------------|------------------|----------------|
|                                  | 30 - 59 Days<br>Past<br>Due | 60 - 89 Days<br>Past Due | 90+ Days<br>Past Due | Total<br>Past Due | Current<br>Loans | Total<br>Loans |
| (Amounts in thousands)           |                             |                          |                      |                   |                  |                |
| Covered loans                    |                             |                          |                      |                   |                  |                |
| Commercial loans                 |                             |                          |                      |                   |                  |                |
| Construction commercial          | \$ 893                      | \$ 323                   | \$ 8,216             | \$ 9,432          | \$ 8,338         | \$ 17,770      |
| Land development                 |                             |                          |                      |                   |                  |                |
| Other land loans                 |                             |                          |                      |                   |                  |                |
| Commercial and industrial        |                             | 73                       | 255                  | 328               | 7,335            | 7,663          |
| Multi-family residential         |                             |                          | 563                  | 563               | 3,143            | 3,706          |
| Single family non-owner occupied |                             |                          |                      |                   |                  |                |
| Non-farm, non-residential        | 117                         | 61                       | 5,506                | 5,684             | 61,607           | 66,751         |
| Agricultural                     |                             |                          |                      |                   | 307              | 307            |
| Farmland                         |                             |                          | 241                  | 241               | 1,104            | 1,345          |
| Consumer real estate loans       |                             |                          |                      |                   |                  |                |
| Home equity lines                | 436                         | 26                       | 192                  | 654               | 87,854           | 88,508         |
| Single family owner occupied     | 472                         | 161                      | 3,904                | 4,537             | 41,154           | 45,691         |
| Owner occupied construction      | 167                         |                          | 393                  | 560               | 1,942            | 2,502          |
| Consumer and other loans         |                             |                          |                      |                   |                  |                |
| Consumer loans                   |                             |                          | 93                   | 93                | 4,441            | 4,534          |
| Other                            |                             |                          |                      |                   |                  |                |

|                     |          |        |           |           |            |            |
|---------------------|----------|--------|-----------|-----------|------------|------------|
| Total covered loans | \$ 2,085 | \$ 644 | \$ 19,363 | \$ 22,092 | \$ 216,685 | \$ 238,777 |
|---------------------|----------|--------|-----------|-----------|------------|------------|

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|                                  | December 31, 2011           |                          |                      |                   |                  |                |
|----------------------------------|-----------------------------|--------------------------|----------------------|-------------------|------------------|----------------|
|                                  | 30 - 59 Days<br>Past<br>Due | 60 - 89 Days<br>Past Due | 90+ Days<br>Past Due | Total<br>Past Due | Current<br>Loans | Total<br>Loans |
| <i>(Amounts in thousands)</i>    |                             |                          |                      |                   |                  |                |
| Commercial loans                 |                             |                          |                      |                   |                  |                |
| Construction commercial          | \$ 48                       | \$                       | \$ 411               | \$ 459            | \$ 35,023        | \$ 35,482      |
| Land development                 |                             |                          | 297                  | 297               | 2,605            | 2,902          |
| Other land loans                 | 205                         |                          | 279                  | 484               | 22,900           | 23,384         |
| Commercial and industrial        | 150                         | 30                       | 3,568                | 3,748             | 88,191           | 91,939         |
| Multi-family residential         | 667                         |                          | 342                  | 1,009             | 76,041           | 77,050         |
| Single family non-owner occupied | 1,222                       | 414                      | 1,020                | 2,656             | 104,087          | 106,743        |
| Non-farm, non-residential        | 837                         | 860                      | 2,180                | 3,877             | 332,128          | 336,005        |
| Agricultural                     |                             | 7                        |                      | 7                 | 1,367            | 1,374          |
| Farmland                         | 152                         |                          | 258                  | 410               | 36,751           | 37,161         |
| Consumer real estate loans       |                             |                          |                      |                   |                  |                |
| Home equity lines                | 642                         | 222                      | 235                  | 1,099             | 110,288          | 111,387        |
| Single family owner occupied     | 5,230                       | 1,993                    | 5,333                | 12,556            | 460,511          | 473,067        |
| Owner occupied construction      |                             | 29                       |                      | 29                | 19,548           | 19,577         |
| Consumer and other loans         |                             |                          |                      |                   |                  |                |
| Consumer loans                   | 198                         | 71                       | 12                   | 281               | 66,848           | 67,129         |
| Other                            |                             |                          |                      |                   | 12,867           | 12,867         |
| Total loans                      | \$ 9,351                    | \$ 3,626                 | \$ 13,935            | \$ 26,912         | \$ 1,369,155     | \$ 1,396,067   |

The Company's troubled debt restructurings (TDRs) totaled \$7.46 million at June 30, 2012, and \$9.45 million at December 31, 2011, which are reported net of those on nonaccrual status of \$4.78 million and \$3.27 million, respectively. Accruing nonperforming TDRs amounted to \$469 thousand, or 6.29% of total accruing TDRs at June 30, 2012, and \$600 thousand, or 6.35% of total TDRs at December 31, 2011. The allowance for loan losses included reserves related to TDRs of \$675 thousand and \$1.14 million at June 30, 2012, and December 31, 2011, respectively. Interest income recognized on TDRs for the three and six months ended June 30, 2012, totaled \$81 thousand and \$175 thousand, respectively. Interest income recognized on TDRs for the three and six months ended June 30, 2011, totaled \$210 thousand and \$333 thousand, respectively. There were no covered loans recorded as TDRs at June 30, 2012.

When restructuring loans for borrowers experiencing financial difficulty, the Company generally makes concessions in interest rates, loan terms and/or amortization terms. All restructured loans to borrowers experiencing financial difficulty in excess of \$250 thousand are evaluated for a specific reserve based on the net present value method. Restructured loans under \$250 thousand are subject to the reserve calculation at the historical loss rate for classified loans. Certain TDRs are classified as nonperforming at time of restructuring and are returned to performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs.

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The following tables present information for loans modified as TDRs, excluding those on nonaccrual status, that were restructured during the three and six months ended June 30, 2012 and 2011 by type of concession made and loan class. The post-modification recorded investment represents the loan balance immediately following modification.

|                              | Three Months Ended June 30, |                                      |                                       | 2011            |                                      |                                       |
|------------------------------|-----------------------------|--------------------------------------|---------------------------------------|-----------------|--------------------------------------|---------------------------------------|
|                              | 2012                        |                                      |                                       | 2011            |                                      |                                       |
| (Amounts in thousands)       | Total Contracts             | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Total Contracts | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
| Below market interest rate   |                             |                                      |                                       |                 |                                      |                                       |
| Non-farm, non-residential    |                             | \$                                   | \$                                    | 1               | \$ 373                               | \$ 373                                |
| Single family owner occupied |                             |                                      |                                       | 2               | 445                                  | 445                                   |
| Total                        |                             | \$                                   | \$                                    | 3               | \$ 818                               | \$ 818                                |

|                              | Six Months Ended June 30, |                                      |                                       | 2011            |                                      |                                       |
|------------------------------|---------------------------|--------------------------------------|---------------------------------------|-----------------|--------------------------------------|---------------------------------------|
|                              | 2012                      |                                      |                                       | 2011            |                                      |                                       |
| (Amounts in thousands)       | Total Contracts           | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Total Contracts | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
| Below market interest rate   |                           |                                      |                                       |                 |                                      |                                       |
| Non-farm, non-residential    |                           | \$                                   | \$                                    | 2               | \$ 480                               | \$ 480                                |
| Single family owner occupied |                           |                                      |                                       | 3               | 726                                  | 703                                   |
| Total                        |                           |                                      |                                       | 5               | 1,206                                | 1,183                                 |
| Extended payment term        |                           |                                      |                                       |                 |                                      |                                       |
| Single family owner occupied | 1                         | 351                                  | 318                                   |                 |                                      |                                       |
| Total                        | 1                         | 351                                  | 318                                   |                 |                                      |                                       |
| Total                        | 1                         | \$ 351                               | \$ 318                                | 5               | \$ 1,206                             | \$ 1,183                              |

There were no payment defaults on loans modified as TDRs during the three and six months ended June 30, 2012 or 2011 that were restructured within the previous 12 months.

**Note 7. FDIC Loss Share Agreement Receivable**

On June 8, 2012, the Company entered into a purchase and assumption agreement with loss share arrangements with the FDIC to purchase certain assets and assume substantially all of the customer deposits and certain liabilities of Waccamaw Bank. Under the loss share agreements, the FDIC has agreed to cover 80% of most loan and foreclosed real estate losses. As of June 30, 2012, the FDIC loss share agreement receivable totaled \$52.07 million.

**Note 8. Deposits**

The following table summarizes interest-bearing deposits by type at June 30, 2012, and December 31, 2011:

| (Amounts in thousands)           | June 30, 2012 | December 31, 2011 |
|----------------------------------|---------------|-------------------|
| Interest-bearing demand deposits | \$ 335,686    | \$ 275,156        |
| Money market deposits            | 238,625       | 167,379           |

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|                                |              |              |
|--------------------------------|--------------|--------------|
| Savings deposits               | 255,891      | 227,328      |
| Individual retirement accounts | 129,722      | 104,601      |
| Certificates of deposit        | 804,388      | 528,735      |
| Total                          | \$ 1,764,312 | \$ 1,303,199 |

**Table of Contents****Note 9. Borrowings**

The following table summarizes borrowings at June 30, 2012, and December 31, 2011:

| <i>(Amounts in thousands)</i>                  | <b>June 30,<br/>2012</b> | <b>December 31,<br/>2011</b> |
|------------------------------------------------|--------------------------|------------------------------|
| Securities sold under agreements to repurchase | \$ 148,367               | \$ 129,208                   |
| FHLB advances                                  | 176,653                  | 150,000                      |
| Subordinated debt                              | 15,464                   | 15,464                       |
| Other debt                                     | 454                      | 469                          |
| <b>Total</b>                                   | <b>\$ 340,938</b>        | <b>\$ 295,141</b>            |

Securities sold under agreements to repurchase consisted of \$90.17 million and \$79.21 million of retail overnight and term repurchase agreements at June 30, 2012, and December 31, 2011, respectively, and \$58.20 million and \$50.00 million of wholesale repurchase agreements at June 30, 2012, and December 31, 2011, respectively. The weighted average contractual rate of the wholesale repurchase agreements was 3.37% at June 30, 2012, and 3.65% at December 31, 2011. Securities sold under agreements to repurchase are collateralized with agency MBS.

FHLB borrowings included \$164.32 million and \$150.00 million in convertible and callable advances at June 30, 2012, and December 31, 2011, respectively, and \$12.33 million in fixed rate credit at June 30, 2012. The callable advances may be redeemed at quarterly intervals after various lockout periods. These call options may substantially shorten the lives of these instruments. If these advances are called, the debt may be paid in full or converted to another FHLB credit product. Prepayment of the advances may result in substantial penalties based upon the differential between contractual note rates and current advance rates for similar maturities. The weighted average contractual rate of FHLB advances was 3.55% and 4.12% at June 30, 2012, and December 31, 2011, respectively. Advances from the FHLB were secured by qualifying loans of \$1.04 billion and \$693.33 million at June 30, 2012 and December 31, 2011, respectively. At June 30, 2012, unused borrowing capacity with the FHLB totaled \$278.89 million.

At June 30, 2012, the FHLB advances had approximate contractual maturities between two months and nine years. The scheduled maturities of the advances are as follows:

| <i>(Amounts in thousands)</i> | <b>Amount</b>     |
|-------------------------------|-------------------|
| 2012                          | \$ 15,095         |
| 2013                          | 11,558            |
| 2014                          |                   |
| 2015                          |                   |
| 2016                          |                   |
| 2017 and thereafter           | 150,000           |
| <b>Total</b>                  | <b>\$ 176,653</b> |

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

**Table of Contents****Note 10. Defined Benefit Plans Net Periodic Benefit Cost**

The Company maintains the Supplemental Executive Retention Plan ( SERP ) for key members of senior management. The following table sets forth the components of net periodic benefit cost recognized for the domestic, noncontributory, nonqualified defined SERP for the dates indicated:

| <i>(Amounts in thousands)</i>      | <b>Three Months Ended</b> |               | <b>Six Months Ended</b> |               |
|------------------------------------|---------------------------|---------------|-------------------------|---------------|
|                                    | <b>June 30,</b>           |               | <b>June 30,</b>         |               |
|                                    | <b>2012</b>               | <b>2011</b>   | <b>2012</b>             | <b>2011</b>   |
| Service cost                       | \$ 39                     | \$ 40         | \$ 77                   | \$ 80         |
| Interest cost                      | 51                        | 56            | 101                     | 111           |
| Amortization of gains (losses)     | 11                        |               | 22                      |               |
| Amortization of prior service cost | 34                        | 33            | 67                      | 66            |
| <b>Net periodic cost</b>           | <b>\$ 134</b>             | <b>\$ 129</b> | <b>\$ 267</b>           | <b>\$ 257</b> |

The Company maintains the Directors Supplemental Retirement Plan ( Directors Plan ) for nonmanagement directors. The following table sets forth the components of net periodic benefit cost recognized for the domestic, noncontributory, nonqualified Directors Plan for the dates indicated:

| <i>(Amounts in thousands)</i>      | <b>Three Months Ended</b> |              | <b>Six Months Ended</b> |              |
|------------------------------------|---------------------------|--------------|-------------------------|--------------|
|                                    | <b>June 30,</b>           |              | <b>June 30,</b>         |              |
|                                    | <b>2012</b>               | <b>2011</b>  | <b>2012</b>             | <b>2011</b>  |
| Service cost                       | \$ 6                      | \$ 7         | \$ 13                   | \$ 14        |
| Interest cost                      | 10                        | 11           | 20                      | 22           |
| Amortization of prior service cost | 23                        | 22           | 45                      | 45           |
| <b>Net periodic cost</b>           | <b>\$ 39</b>              | <b>\$ 40</b> | <b>\$ 78</b>            | <b>\$ 80</b> |

**Note 11. Commitments and Contingencies**

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

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. At June 30, 2012, and December 31, 2011, commitments to extend credit, including availability on lines of credit, totaled \$234.64 million and \$194.27 million, respectively. Additionally, the Company had gross notional amounts of outstanding commitments related to secondary market mortgage loans at June 30, 2012, and December 31, 2011, of \$16.60 million and \$9.15 million, respectively.

Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to

customers. To the extent deemed necessary, collateral of varying types and amounts is held to secure customer performance under certain of those letters of credit outstanding. At June 30, 2012, and December 31, 2011, standby letters of credit and financial guarantees totaled \$4.36 million and \$2.90 million, respectively. The Company maintained a reserve for unfunded lending commitments of \$326 thousand and \$329 thousand at June 30, 2012, and December 31, 2011, respectively.

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The Company has issued, through the Trust, \$15.00 million of trust preferred securities in a private placement. In connection with the issuance of the trust preferred securities, the Company has committed to irrevocably and unconditionally guarantee the following payments or distributions with respect to the trust preferred securities to the holders thereof to the extent that the Trust has not made such payments or distributions and has the funds therefore: (i) accrued and unpaid distributions, (ii) the redemption price, and (iii) upon a dissolution or termination of the Trust, the lesser of the liquidation amount and all accrued and unpaid distributions and the amount of assets of the Trust remaining available for distribution.

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

### **Note 12. Fair Value**

#### ***Fair Value Measurements***

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal, or most advantageous, market under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. The price in the principal, or most advantageous, market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal, or most advantageous, market that are independent, knowledgeable, and able and willing to enter into a transaction.

The fair value hierarchy categorizes the inputs to valuation techniques as follows:

|                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Level 1 Inputs | Observable inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| Level 2 Inputs | Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and provide a reasonable basis for fair value determination, such as interest rates, yield curves, and implied volatilities, and credit spreads, or inputs that are derived principally from observable market data. |
| Level 3 Inputs | Unobservable inputs used to measure fair value for the asset or liability for which there is little, if any, market activity at the measurement date. These inputs are developed using the best information available at the time to the extent that inputs are available without undue cost and effort. These inputs and assumptions may include an entity's own assumptions and model-derived inputs that are not corroborated by observable market data.                                                                                                                                                                 |

The Company's fair value valuation techniques were applied to all of the Company's assets and liabilities carried at fair value. In general, fair value is based upon quoted market prices. If quoted market prices are not available, fair value is based upon third party models that primarily use observable market-based parameters as input. Valuation adjustments, including amounts to reflect counterparty credit quality, the Company's creditworthiness, and unobservable parameters, may be made to ensure that financial instruments are recorded at fair value. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value could result in a different estimate of fair value at the reporting date.

*Securities Available-for-Sale:* Securities classified as available-for-sale are recorded at fair value on a recurring basis utilizing Level 1, Level 2, and Level 3 inputs. Securities are classified as Level 1 when quoted prices are available in an active market. Level 1 inputs are used to value securities whose value is based on quoted market prices in active markets for identical assets, including U.S. treasury securities. The Company also uses Level 1 inputs for the valuation of equity securities traded in active markets.



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Securities are classified as Level 2 when the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other inputs. Level 2 inputs are used to value U.S. agency securities, states and political subdivisions, single issue trust preferred securities, corporate FDIC insured securities, MBS, and certain equity securities that are not actively traded.

Securities are classified as Level 3 when there is limited activity or less transparency to the valuation inputs. In the absence of observable or corroborated market data, internally developed estimates that incorporate market-based assumptions, when available, are used. There were no securities classified as Level 3 at June 30, 2012, or December 31, 2011.

Fair value models may be required when trading activity has declined significantly or does not exist, or when prices are not current or pricing variations are significant. The Company's third party fair value model utilizes modeling software that incorporates market participant data and knowledge of the structure of each individual security to develop cash flows specific to each security. The fair values of the securities are determined by using the cash flows developed by the fair value model and applying appropriate market observable discount rates. The discount rates are developed by determining credit spreads above a benchmark rate, such as LIBOR, and adding premiums for illiquidity based on a comparison of initial issuance spread to LIBOR versus a financial sector curve for recently issued debt to LIBOR. Specific securities that have increased uncertainty regarding the receipt of cash flows are discounted at higher rates due to the addition of a deal specific credit premium based on assumptions about the performance of the underlying collateral. Finally, internal fair value model pricing and external pricing observations are combined by assigning weights to each pricing observation. Pricing is reviewed for reasonableness based on the direction of the specific markets and the general economic indicators. The following summary describes the valuation techniques used by the Company to measure certain assets and liabilities recorded at fair value:

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

*Derivative Instruments:* Derivatives are recorded at fair value on a recurring basis utilizing Level 2 inputs. The Company obtains dealer quotes based on observable market data to value derivatives. See Note 12, *Derivative Instruments and Hedging Activities*, for additional information.

*Impaired Loans:* Certain impaired loans, including restructured loans, are recorded at fair value on a nonrecurring basis using Level 3 inputs when repayment is expected solely from the sale of the underlying collateral. Collateral values are based on appraisals and adjusted for customized discounting criteria. In the Company's experience, it rarely returns loans to performing status after they have been partially charged off. Generally, credits identified as impaired move quickly through the process towards ultimate resolution.

*Other Real Estate Owned (OREO):* OREO is recorded at fair value on a nonrecurring basis using Level 3 inputs. Real estate values are based on current and prior appraisals, estimated sales costs, and proprietary qualitative adjustments.

*Goodwill:* Goodwill is recorded at fair value on a nonrecurring basis using Level 3 inputs. When the book value of a reporting unit exceeds its determined fair value, goodwill impairment exists and the reporting unit is adjusted to fair value. Fair value is determined using discounted cash flow and market multiple models.

**Table of Contents*****Recurring and Nonrecurring Fair Value***

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy for the periods indicated:

|                                         | Total<br>Fair<br>Value | June 30, 2012<br>Fair Value Measurements Using |            |         |
|-----------------------------------------|------------------------|------------------------------------------------|------------|---------|
|                                         |                        | Level 1                                        | Level 2    | Level 3 |
| (Amounts in thousands)                  |                        |                                                |            |         |
| Available-for-sale securities:          |                        |                                                |            |         |
| Municipal securities                    | \$ 151,991             | \$                                             | \$ 151,991 | \$      |
| Single issue trust preferred securities | 44,506                 |                                                | 44,506     |         |
| Corporate FDIC insured securities       | 13,550                 |                                                | 13,550     |         |
| Agency MBS                              | 306,089                |                                                | 306,089    |         |
| Non-Agency Alt-A residential MBS        | 9,926                  |                                                | 9,926      |         |
| Equity securities                       | 545                    | 525                                            | 20         |         |
|                                         |                        |                                                |            |         |
| Total available-for-sale securities     | \$ 526,607             | \$ 525                                         | \$ 526,082 | \$      |
|                                         |                        |                                                |            |         |
| Deferred compensation assets            | \$ 3,467               | \$ 3,467                                       | \$         | \$      |
|                                         |                        |                                                |            |         |
| Derivatives                             |                        |                                                |            |         |
| Interest rate lock commitments          | \$ 206                 | \$                                             | \$ 206     | \$      |
|                                         |                        |                                                |            |         |
| Deferred compensation liabilities       | \$ 3,467               | \$ 3,467                                       | \$         | \$      |
|                                         |                        |                                                |            |         |
| Derivative liabilities                  |                        |                                                |            |         |
| Interest rate lock commitments          | \$ 2                   | \$                                             | \$ 2       | \$      |

|                                         | Total<br>Fair<br>Value | December 31, 2011<br>Fair Value Measurements Using |            |         |
|-----------------------------------------|------------------------|----------------------------------------------------|------------|---------|
| (Amounts in thousands)                  |                        | Level 1                                            | Level 2    | Level 3 |
| Available-for-sale securities:          |                        |                                                    |            |         |
| Municipal securities                    | \$ 137,815             | \$                                                 | \$ 137,815 | \$      |
| Single issue trust preferred securities | 40,244                 |                                                    | 40,244     |         |
| Corporate FDIC insured securities       | 13,718                 |                                                    | 13,718     |         |
| Agency MBS                              | 280,102                |                                                    | 280,102    |         |
| Non-Agency Alt-A residential MBS        | 10,030                 |                                                    | 10,030     |         |
| Equity securities                       | 521                    | 501                                                | 20         |         |
| Total available-for-sale securities     | \$ 482,430             | \$ 501                                             | \$ 481,929 | \$      |
| Deferred compensation assets            | \$ 3,210               | \$ 3,210                                           | \$         | \$      |
| Derivative assets                       |                        |                                                    |            |         |
| Interest rate lock commitments          | \$ 135                 | \$                                                 | \$ 135     | \$      |
| Deferred compensation liabilities       | \$ 3,210               | \$ 3,210                                           | \$         | \$      |
| Derivative liabilities                  |                        |                                                    |            |         |

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|                                |    |   |    |    |   |    |
|--------------------------------|----|---|----|----|---|----|
| Interest rate lock commitments | \$ | 6 | \$ | \$ | 6 | \$ |
|--------------------------------|----|---|----|----|---|----|

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The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in certain circumstances such as evidence of impairment. The following tables summarize financial and nonfinancial assets measured at fair value on a nonrecurring basis during the periods presented, segregated by the level of the valuation inputs within the fair value hierarchy that were held for the periods indicated.

| (Amounts in thousands)                              | June 30, 2012       |                               |         |          |
|-----------------------------------------------------|---------------------|-------------------------------|---------|----------|
|                                                     | Total<br>Fair Value | Fair Value Measurements Using |         |          |
|                                                     |                     | Level 1                       | Level 2 | Level 3  |
| Impaired loans not covered by loss share agreements | \$ 6,254            |                               |         | \$ 6,254 |
| OREO not covered by loss share agreements           | 3,951               |                               |         | 3,951    |

| (Amounts in thousands)      | December 31, 2011   |                               |         |           |
|-----------------------------|---------------------|-------------------------------|---------|-----------|
|                             | Total<br>Fair Value | Fair Value Measurements Using |         |           |
|                             |                     | Level 1                       | Level 2 | Level 3   |
| Impaired loans              | \$ 12,022           | \$                            | \$      | \$ 12,022 |
| OREO                        | 5,914               |                               |         | 5,914     |
| Goodwill insurance agencies | 9,405               |                               |         | 9,405     |

There were no transfers between valuation levels for any asset during the three and six months ended June 30, 2012 or 2011. If valuation techniques are deemed necessary, the Company considers those transfers to occur at the end of the period when the assets are valued.

The following table presents quantitative information about financial and nonfinancial assets measured at fair value on a nonrecurring basis using Level 3 valuation inputs:

| (Amounts in thousands) | Valuation                      |                                      | Unobservable                         |  | Range              |
|------------------------|--------------------------------|--------------------------------------|--------------------------------------|--|--------------------|
|                        | Fair Value at<br>June 30, 2012 | Technique                            | Input                                |  | (Weighted Average) |
| Impaired loans         | \$ 6,254                       | Discounted appraisals <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> |  | 4% to 100% (58%)   |
| OREO                   | 3,951                          | Discounted appraisals <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> |  | 0% to 67% (23%)    |

(1) Fair value is generally based on appraisals of the underlying collateral.

(2) Appraisals may be adjusted by management for customized discounting criteria, estimated sales costs, and proprietary qualitative adjustments.

**Fair Value of Financial Instruments**

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

**Cash and Cash Equivalents:** The carrying amount of cash and due from banks and federal funds sold/purchased is considered equal to the fair value as a result of the short-term nature of these instruments.

**Investment Securities:** The determination of the fair value of available-for-sale securities is described within Fair Value Measurements presented above. The determination of the fair value of held-to-maturity securities is based on quoted market prices or dealer quotes.

**Loans Held for Sale:** Loans held for sale are recorded at the lower of cost or estimated fair value. The determination of the fair value of loans held for sale is based on the market price of similar loans.



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*Loans Held for Investment:* The determination of the fair value of loans held for investment is based on discounted future cash flows using current rates for similar loans.

*FDIC Receivable under Loss Share Agreements:* The determination of the fair value is based on discounted future cash flows using current discount rates.

*Accrued Interest Receivable/Payable:* The carrying amount of accrued interest receivable/payable is considered equal to the fair value as a result of the short-term nature of these instruments.

*Derivative Financial Instruments:* The determination of the fair value of derivative financial instruments is described within Fair Value Measurements presented above.

*Deferred Compensation Instruments:* The determination of the fair value of deferred compensation instruments is described within Fair Value Measurements presented above.

*Deposits and Securities Sold Under Agreements to Repurchase:* The fair value of deposits without a stated maturity, including demand, interest-bearing demand, and savings, is considered equal to the carrying amount which is the amount payable on demand at the reporting date. The fair value of deposits and repurchase agreements with fixed maturities and rates is estimated using discounted future cash flows that apply interest rates currently being offered on instruments with similar characteristics and maturities.

*FHLB and Other Indebtedness:* The determination of the fair value of FHLB and other indebtedness is based on interest rates currently available to the Company for borrowings with similar characteristics and maturities. The determination of fair value for trust preferred obligations is based on credit spreads seen in the marketplace for similar issues.

*Off-Balance Sheet Instruments:* The value of off-balance sheet instruments, including commitments to extend credit, standby letters of credit, and financial guarantees, is considered equal to fair value. Due to the uncertainty involved in assessing the likelihood and timing of commitments being drawn upon, coupled with the lack of an established market and the wide diversity of fee structures, the Company does not believe it is meaningful to provide an estimate of fair value that differs from the given value of the commitment.

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The following tables summarize the carrying amount and fair value of the Company's financial instruments for the dates indicated:

|                                                |                 |            | June 30, 2012                 |            |           |
|------------------------------------------------|-----------------|------------|-------------------------------|------------|-----------|
| (Amounts in thousands)                         | Carrying Amount | Fair Value | Fair Value Measurements Using |            |           |
|                                                |                 |            | Level 1                       | Level 2    | Level 3   |
| Assets                                         |                 |            |                               |            |           |
| Cash and cash equivalents                      | \$ 156,165      | \$ 156,165 | \$ 156,165                    | \$         | \$        |
| Available-for-sale securities                  | 526,607         | 526,607    | 525                           | 526,082    |           |
| Held-to-maturity securities                    | 1,295           | 1,318      |                               | 1,318      |           |
| Loans held for sale                            | 1,179           | 1,204      |                               | 1,204      |           |
| Loans held for investment less allowance       |                 |            |                               |            |           |
| Covered under loss share agreements            | 238,777         | 238,777    |                               |            | 238,777   |
| Not covered under loss share agreements        | 1,542,141       | 1,566,485  |                               |            | 1,566,485 |
| FDIC receivable under loss share agreements    | 52,067          | 52,067     |                               |            | 52,067    |
| Accrued interest receivable                    | 8,396           | 8,396      |                               | 8,396      |           |
| Derivative financial assets                    | 206             | 206        |                               | 206        |           |
| Deferred compensation assets                   | 3,467           | 3,467      | 3,467                         |            |           |
| Liabilities                                    |                 |            |                               |            |           |
| Demand deposits                                | \$ 340,895      | \$ 340,895 | \$                            | \$ 340,895 | \$        |
| Interest-bearing demand deposits               | 335,686         | 335,686    |                               | 335,686    |           |
| Savings deposits                               | 494,516         | 494,516    |                               | 494,516    |           |
| Time deposits                                  | 934,110         | 961,682    |                               | 961,682    |           |
| Securities sold under agreements to repurchase | 148,367         | 156,643    |                               | 156,643    |           |
| Accrued interest payable                       | 2,708           | 2,708      |                               | 2,708      |           |
| FHLB and other indebtedness                    | 192,571         | 212,190    |                               | 212,190    |           |
| Derivative financial liabilities               | 2               | 2          |                               | 2          |           |
| Deferred compensation liabilities              | 3,467           | 3,467      | 3,467                         |            |           |

| (Amounts in thousands)                         | December 31, 2011  |            |
|------------------------------------------------|--------------------|------------|
|                                                | Carrying<br>Amount | Fair Value |
| <b>Assets</b>                                  |                    |            |
| Cash and cash equivalents                      | \$ 47,294          | \$ 47,294  |
| Investment securities                          | 485,920            | 485,962    |
| Loans held for sale                            | 5,820              | 5,877      |
| Loans held for investment less allowance       | 1,369,862          | 1,386,419  |
| Accrued interest receivable                    | 6,193              | 6,193      |
| Derivative financial assets                    | 135                | 135        |
| Deferred compensation assets                   | 3,210              | 3,210      |
| <b>Liabilities</b>                             |                    |            |
| Demand deposits                                | \$ 240,268         | \$ 240,268 |
| Interest-bearing demand deposits               | 275,156            | 275,156    |
| Savings deposits                               | 394,707            | 394,707    |
| Time deposits                                  | 633,336            | 641,604    |
| Securities sold under agreements to repurchase | 129,208            | 136,359    |
| Accrued interest payable                       | 2,554              | 2,554      |
| FHLB and other indebtedness                    | 165,933            | 183,722    |
| Derivative financial liabilities               | 6                  | 6          |
| Deferred compensation liabilities              | 3,210              | 3,210      |

**Table of Contents****Note 13. Derivative Instruments and Hedging Activities**

The Company uses derivative instruments primarily to protect against the risk of adverse price or interest rate movements on the value of certain assets and liabilities and on future cash flows. These derivatives may consist of interest rate swaps, floors, caps, collars, futures, forward contracts, and written and purchased options. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another asset to the other party based on a notional amount and an underlying asset as specified in the contract. Derivative assets and liabilities are recorded at fair value on the balance sheet.

Like other financial instruments, derivatives contain an element of credit risk due to the possibility the Company may incur a loss if a counterparty fails to meet its contractual obligations. This risk is measured as the expected positive replacement value of contracts. All derivative contracts may be executed only with exchanges or counterparties approved by the Company's Asset/Liability Management Committee.

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

*IRLC*: In the normal course of business, the Company sells originated mortgage loans into the secondary mortgage loan market. The Company enters into IRLCs to provide potential borrowers an interest rate guarantee. Once a mortgage loan is closed and funded, it is included within loans held for sale and awaits sale and delivery into the secondary market. From the loan closing date through the date of sale into the secondary market, the Company has exposure to interest rate movement resulting from the risk that interest rates will change from the rate quoted to the borrower. Due to these interest rate fluctuations, the Company's balance of mortgage loans held for sale is subject to changes in fair value. Typically, the fair value of these loans decline when interest rates increase and rise when interest rates decrease.

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

| <i>(Amounts in thousands)</i>              | <b>June 30, 2012</b> | <b>December 31, 2011</b> | <b>June 30, 2011</b> |
|--------------------------------------------|----------------------|--------------------------|----------------------|
| Derivatives not designated as hedges IRLCs | \$ 16,604            | \$ 9,155                 | \$ 3,500             |

The following table presents the fair value of derivative financial instruments as of the dates indicated:

| <i>(Amounts in thousands)</i>              | <b>June 30, 2012</b>          |                   | <b>December 31, 2011</b>      |                   | <b>June 30, 2011</b>          |                   |
|--------------------------------------------|-------------------------------|-------------------|-------------------------------|-------------------|-------------------------------|-------------------|
|                                            | <b>Balance Sheet Location</b> | <b>Fair Value</b> | <b>Balance Sheet Location</b> | <b>Fair Value</b> | <b>Balance Sheet Location</b> | <b>Fair Value</b> |
| <b>Asset derivatives</b>                   |                               |                   |                               |                   |                               |                   |
| Derivatives not designated as hedges IRLCs | Other assets                  | \$ 206            | Other assets                  | \$ 135            | Other assets                  | \$ 39             |
| <b>Total</b>                               |                               | <b>\$ 206</b>     |                               | <b>\$ 135</b>     |                               | <b>\$ 39</b>      |
| <b>Liability derivatives</b>               |                               |                   |                               |                   |                               |                   |
| Derivatives not designated as hedges IRLCs | Other liabilities             | \$ 2              | Other liabilities             | \$ 6              | Other liabilities             | \$ 7              |
| <b>Total</b>                               |                               | <b>\$ 2</b>       |                               | <b>\$ 6</b>       |                               | <b>\$ 7</b>       |

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For the quarters ended June 30, 2012 and 2011, the Company determined there was no amount of ineffectiveness on cash flow hedges. The following table details gains and losses recognized in income on derivatives for the dates indicated:

| (Amounts in thousands)                     | Income Statement<br>Location | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |       |
|--------------------------------------------|------------------------------|--------------------------------|---------|------------------------------|-------|
|                                            |                              | 2012                           | 2011    | 2012                         | 2011  |
| Derivatives not designated as hedges IRLCs | Other income                 | \$ 161                         | \$ (18) | \$ 76                        | \$ 63 |
| Total                                      |                              | \$ 161                         | \$ (18) | \$ 76                        | \$ 63 |

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

Unless the context suggests otherwise, the terms First Community, Company, we, our, and us refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity. The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide information that will enhance understanding of our Company's financial condition, changes in financial condition, and results of operations. This MD&A contains forward-looking statements and should be read in conjunction with our 2011 Annual Report on Form 10-K (the 2011 Form 10-K) and the other financial information included in this report.

#### **Forward-Looking Statements**

We may make forward-looking statements in filings with the Securities and Exchange Commission (the SEC) including this Quarterly Report on Form 10-Q and the Exhibits hereto and thereto in our reports to shareholders and other communications that are made in good faith by our Company pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements with respect to our beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words may, could, should, would, believe, anticipate, estimate, expect, intend, plan, and other similar expressions identify forward-looking statements. The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

the strength of the United States economy in general and the strength of the local economies in which we conduct operations;

the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve Board;

inflation, interest rate, market and monetary fluctuations;

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

the willingness of customers to substitute competitors' products and services for our products and services and vice versa;

the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities, and insurance) and the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act);

the impact of the U.S. Treasury and federal banking regulators continued implementation of a number of programs to address capital and liquidity in the banking system; further, future and proposed rules, including those that are part of the Basel III process, are expected to require banking institutions to increase levels of capital; technological changes;

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

the growth and profitability of our noninterest, or fee, income being less than expected;

unanticipated regulatory or judicial proceedings;

changes in consumer spending and saving habits; and

our success at managing the risks involved in the foregoing.

We caution that the foregoing list of important factors is not all-inclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, then our actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Quarterly Report on Form 10-Q and other reports we filed with the SEC. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We do not intend to update any forward-looking statements, whether written or oral, to reflect change. All forward-looking statements attributable to our Company are expressly qualified by these cautionary statements. These factors and other risks and uncertainties are discussed in Part II, Item 1A, Risk Factors, herein and Part I, Item 1A, Risk Factors, of our 2011 Form 10-K.

### **Company Overview**

Our Company is a financial holding company headquartered in Bluefield, Virginia. We operate through our community bank subsidiary, First Community Bank (the Bank), which provides financial, trust, and investment advisory services to individuals and commercial customers through seventy-four locations in Virginia, West Virginia, North Carolina, South Carolina, and Tennessee. Our Company is also the parent company of Greenpoint Insurance Group, Inc. (Greenpoint), headquartered in

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High Point, North Carolina, a full-service insurance agency offering commercial and personal lines of insurance through six locations in Virginia, West Virginia, and North Carolina. The Bank is the parent of First Community Wealth Management, a registered investment advisory firm that offers wealth management and investment advice with \$883 million in aggregate assets under management as of June 30, 2012. These assets are not assets of our Company, but are managed under various fee-based arrangements as fiduciary or agent. We reported total assets of \$2.81 billion as of June 30, 2012. Our Common Stock is traded on the NASDAQ Global Select Market under the symbol FCBC.

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

## **Critical Accounting Estimates**

We prepare our consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) and conform to general practices within the banking industry. Our financial position and results of operations require management to make judgments and estimates to develop the amounts reflected and disclosed in the consolidated financial statements. Different assumptions in the application of these estimates could result in material changes to our consolidated financial position and consolidated results of operations. Estimates, assumptions, and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Our accounting estimates are fundamental to understanding MD&A and the disclosures presented in the Notes to Consolidated Financial Statements and in MD&A provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Our critical accounting estimates are described in detail in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of our 2011 Form 10-K.

## **Dodd-Frank Wall Street Reform and Consumer Protection Act**

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

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

Requires financial holding companies, such as our Company, to be well capitalized and well managed as of July 21, 2011. Bank holding companies and banks must also be well capitalized and well managed to engage in interstate bank acquisitions.

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

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

Makes permanent the \$250 thousand limit for federal deposit insurance and provides unlimited federal deposit insurance until January 1, 2013, for noninterest-bearing demand transaction accounts at all insured depository institutions.

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

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

Increases the authority of the Federal Reserve Board to examine bank holding companies, such as our Company, and their nonbank subsidiaries.

Another section of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act (the Mortgage Reform Act ), contains new underwriting and servicing standards for the mortgage industry, as well as restrictions on compensation

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for mortgage originators. In addition, the Mortgage Reform Act grants broad discretionary regulatory authority to the CFPB to prohibit or condition terms, acts, or practices relating to residential mortgage loans that the CFPB finds abusive, unfair, deceptive, or predatory, as well as to take other actions that the CFPB finds are necessary or proper to ensure that responsible affordable mortgage credit remains available to consumers. The Dodd-Frank Act also contains laws affecting the securitization of mortgages, and other assets, with requirements for risk retention by securitizers and requirements for regulating credit rating agencies. Many aspects of the Dodd-Frank Act continue to be subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on our Company, our customers, or the general financial industry. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits, and interchange fees could increase costs associated with deposits, as well as place limitations on certain revenues those deposits may generate.

## **Recent Business Combinations**

On June 8, 2012, the Company entered into a purchase and assumption agreement with a loss share arrangement with the Federal Deposit Insurance Corporation (the FDIC) to purchase certain assets and assume substantially all of the customer deposits and certain liabilities of Waccamaw Bank. Waccamaw, a full service community bank headquartered in Whiteville, North Carolina, operated sixteen branches throughout North and South Carolina. At acquisition, Waccamaw had total assets of approximately \$500.43 million, loans of approximately \$318.32 million, and deposits of approximately \$414.13 million. As a result of the acquisition and the preliminary purchase price allocation, approximately \$7.13 million was recorded as goodwill, which represents the excess fair market value of the net assets acquired and identified intangibles over the purchase price. Under the Single-Family Shared-Loss Agreement and the Commercial Shared-Loss Agreement with the FDIC, the FDIC has agreed to cover 80% of most loan and foreclosed real estate losses. All assets acquired and liabilities assumed are recorded at estimated fair value on the date of acquisition. These fair value estimates are considered preliminary, and are subject to change for up to one year after the closing date of the acquisition as additional information relative to closing date fair values may become available. The Company and the FDIC are engaged in on-going discussions that may impact which assets and liabilities are ultimately acquired or assumed by the Company.

On May 31, 2012, the Company completed the acquisition of Peoples Bank of Virginia, based in Richmond, Virginia. Peoples, a full service community bank headquartered in Richmond, Virginia, operated four branches throughout the Richmond area. At acquisition, Peoples had total assets of approximately \$276.88 million, loans of approximately \$184.84 million, and deposits of approximately \$232.75 million. Under the terms of the merger agreement, shares of Peoples were exchanged for \$6.08 in cash and 1.07 shares of the Company's common stock, resulting in a purchase price of approximately \$40.28 million. As a result of the acquisition and the preliminary purchase price allocation, approximately \$9.02 million was recorded as goodwill, which represents the excess fair market value of the net assets acquired and identified intangibles over the purchase price. These fair value estimates are considered preliminary, and are subject to change for up to one year after the closing date of the acquisition as additional information relative to closing date fair values may become available.

## **Results Of Operations**

### ***Overview***

The following list includes significant developments regarding our Company and operations during the second quarter and first half of 2012:

We completed the acquisition of Peoples on May 31, 2012, and the FDIC-assisted acquisition of Waccamaw on June 8, 2012.

Tax equivalent net interest margin increased 10 basis points during the quarter and 3 basis points during the first half of 2012 compared with the same periods of 2011.

The provision for loan losses was reduced \$1.46 million, or 47.39%, compared with the second quarter of 2011 and \$2.15 million, or 45.81%, compared with the first half of 2011.

Net interest income increased \$1.73 million, or 9.74%, compared with the second quarter of 2011 and \$1.43 million, or 3.97%, compared with the first half of 2011.

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Deposit and borrowing costs decreased \$883 thousand, or 15.82%, compared with the second quarter of 2011 and \$2.49 million, or 20.96%, compared with the first half of 2012.

Net charge-offs decreased \$1.83 million, or 59.43%, compared with the second quarter of 2011 and \$2.12 million, or 45.09%, compared with the first half of 2011.

### ***Net Income***

Net income decreased \$1.65 million, or 28.81%, to \$4.08 million for the second quarter of 2012 compared with \$5.73 million for the second quarter of 2011. Net income available to common shareholders decreased \$1.80 million, or 32.20%, to \$3.80

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million for the second quarter of 2012 compared with \$5.60 million for the second quarter of 2011. The decrease was largely attributed to a reduction in the net gain on sale of securities and increase in merger related expenses associated with the Peoples and Waccamaw acquisitions, offset by decreases in the interest paid on deposit accounts and a reduction to the provision for loan losses. Diluted earnings per common share totaled \$0.20 for the second quarter of 2012 compared to \$0.31 for the second quarter of 2011.

Net income decreased \$1.40 million, or 12.20%, to \$10.08 million for first half of 2012 compared with \$11.48 million for the first half of 2011. Net income available to common shareholders decreased \$1.84 million, or 16.17%, to \$9.51 million for the first half of 2012 compared with \$11.35 million for the first half of 2011. The decrease was largely attributed to a reduction in the net gain on sale of securities, merger related expenses in connection with the Peoples and Waccamaw acquisitions, and a decline in interest and fee income, offset by decreases in the interest paid on deposit accounts and a reduction to the provision for loan losses. Diluted earnings per common share totaled \$0.52 for the first half of 2012 compared to \$0.63 for the first half of 2011.

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

Net interest income, the largest contributor to earnings, increased \$1.73 million, or 9.74%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. Tax equivalent net interest income increased \$1.72 million, or 9.28%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. The increase in tax equivalent net interest income was primarily due to the increase in average earning assets from the Peoples and Waccamaw acquisitions and reductions in the rates paid on interest-bearing deposits resulting from the sustained low rate environment offset by decreases in the yield earned on loans and investment securities.

Average earning assets increased \$134.33 million and average interest-bearing liabilities increased \$56.88 million for the quarter ended June 30, 2012, compared with the same quarter of 2011. The yield on average earning assets decreased 15 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The average rate paid on interest-bearing liabilities decreased 24 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. Average balances and interest yield/rate changes for earning assets and interest-bearing liabilities resulted in a net interest rate spread that was 9 basis points lower for the second quarter of 2012 compared with the second quarter of 2011. Our net interest margin increased 10 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011.

The tax equivalent yield on loans decreased 32 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. Tax equivalent loan interest income increased \$763 thousand, or 3.79%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. The increase in interest income on loans was primarily due to the increase in the average loan balance resulting from the Peoples and Waccamaw acquisitions.

The tax equivalent yield on available-for-sale securities decreased 73 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The decrease was largely due to the sale of higher yielding securities and reinvestment of proceeds from sales, maturities, prepayments, and cash in lower yielding securities. The average balance of held-to-maturity securities continued to decline as securities were called or matured and were not replaced.

The tax equivalent yield on interest-bearing deposits with banks increased 20 basis points for the second quarter of 2012 compared with the second quarter of 2011. Interest-bearing deposits with banks are comprised primarily of excess liquidity kept at the Federal Reserve that bears overnight market rates.

The average balance of interest-bearing demand deposits increased \$16.74 million, or 5.98%, and the average rate paid on those deposits decreased 10 basis points for the second quarter of 2012 compared with the second quarter of 2011. The average balance of savings deposits increased \$6.89 million, or 1.66%, and the average rate paid on those deposits decreased 12 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The average balance of time deposits increased \$27.63 million, or 3.99%, and the average rate paid on those deposits decreased 46 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The average balance of noninterest-bearing demand deposits increased \$50.66 million, or 23.09%, for the second quarter of 2012 compared with the second quarter of 2011.

There were no federal funds purchased on average for the second quarters of 2012 and 2011. The average balance of retail repurchase agreements, including collateralized retail deposits and commercial treasury accounts, decreased \$7.09 million, or 8.67%, and the average rate paid on those funds decreased 10 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The decrease in the average balance of retail repurchase agreements was primarily due to lower balances in commercial treasury accounts in the slow economy. The average balance of wholesale repurchase agreements increased \$4.19 million, or 8.39%, and the average rate paid on those funds decreased 27 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The average balance of FHLB advances and other

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borrowings increased \$8.51 million, or 5.12%, and the average rate paid on those funds decreased 5 basis points for the quarter ended June 30, 2012, compared with the same quarter of 2011. The change in the average balances and costs of wholesale repurchase agreements and FHLB advances are due to the Peoples and Waccamaw acquisitions.

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

Net interest income increased \$1.43 million, or 3.97%, for the six months ended June 30, 2012, compared with the same period of 2011. Tax equivalent net interest income increased \$1.24 million, or 3.28%, for the six months ended June 30, 2012, compared with the same period of 2011. The increase in tax equivalent net interest income was primarily due to reductions in the rates paid on interest-bearing deposits resulting from the sustained low rate environment offset by decreases in the yield earned on loans and investment securities.

Average earning assets increased \$45.65 million and average interest-bearing liabilities decreased \$37.82 million for the six months ended June 30, 2012, compared with the same period of 2011. The yield on average earning assets decreased 26 basis points for the six months ended June 30, 2012, compared with the same period of 2011. The average rate paid on interest-bearing liabilities decreased 27 basis points for the six months ended June 30, 2012, compared with the same period of 2011. Average balances and interest yield/rate changes for earning assets and interest-bearing liabilities resulted in a net interest rate spread that was 1 basis point higher for the first half of 2012 compared with the first half of 2011. Our net interest margin increased 3 basis points for the six months ended June 30, 2012, compared with the same period of 2011.

The tax equivalent yield on loans decreased 36 basis points for the six months ended June 30, 2012, compared with the same period of 2011. Tax equivalent loan interest income decreased \$325 thousand, or 0.80%, for the six months ended June 30, 2012, compared with the same period of 2011. The decrease in interest income on loans was primarily due to the extended low interest rate environment.

The tax equivalent yield on available-for-sale securities decreased 84 basis points for the six months ended June 30, 2012, compared with the same period of 2011. The decrease was largely due to the sale of higher yielding securities in the prior year and reinvestment of proceeds from sales, maturities, prepayments, and cash in lower yielding securities. The average balance of held-to-maturity securities continued to decline as securities were called or matured and were not replaced.

The tax equivalent yield on interest-bearing deposits with banks increased 17 basis points for the first half of 2012 compared with the first half of 2011. Interest-bearing deposits with banks are comprised primarily of excess liquidity kept at the Federal Reserve that bears overnight market rates.

The average balance of interest-bearing demand deposits increased \$13.99 million, or 5.07%, and the average rate paid on those deposits decreased 19 basis points for the first half of 2012 compared with the first half of 2011. The average balance of savings deposits decreased \$12.59 million, or 2.99%, and the average rate paid on those deposits decreased 18 basis points for the six months ended June 30, 2012, compared with the same period of 2011. The average balance of time deposits decreased \$28.65 million, or 4.06%, and the average rate paid on those deposits decreased 45 basis points for the six months ended June 30, 2012, compared with the same period of 2011. The average balance of noninterest-bearing demand deposits increased \$38.80 million, or 17.99%, for the first half of 2012 compared with the first half of 2011. During the six months ended June 30, 2012, customers shifted from time accounts into money market and savings products while we reduced the level of time deposit-only customer relationships.

The average balance of federal funds purchased increased \$985 thousand for the first half of 2012 compared to no federal funds purchased on average for the first half of 2011. The average balance of retail repurchase agreements, including collateralized retail deposits and commercial treasury accounts, decreased \$11.78 million, or 13.83%, and the average rate paid on those funds decreased 13 basis points for the six months ended June 30, 2012, compared with the same period of 2011. The decrease in the average balance of retail repurchase agreements was primarily due to lower balances in commercial treasury accounts in the slow economy. The average balance of wholesale repurchase agreements increased \$2.10 million, or 4.19%, and the average rate paid on those funds decreased 15 basis points for the six months ended June 30, 2012, compared with the same period of 2011. The average balance of FHLB advances and other borrowings decreased \$1.87 million, or 1.08%, and the average rate paid on those funds increased 1 basis point for the six months ended June 30, 2012, compared with the same period of 2011.

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| Average Balance Sheets and Net Interest Income Analysis<br>Three Months Ended June 30, |                    |                         |                                       |                    |                         |                                       |
|----------------------------------------------------------------------------------------|--------------------|-------------------------|---------------------------------------|--------------------|-------------------------|---------------------------------------|
|                                                                                        | 2012               |                         |                                       | 2011               |                         |                                       |
| (Amounts in thousands)                                                                 | Average<br>Balance | Interest <sup>(1)</sup> | Average Yield/<br>Rate <sup>(1)</sup> | Average<br>Balance | Interest <sup>(1)</sup> | Average Yield/<br>Rate <sup>(1)</sup> |
| <b>Assets</b>                                                                          |                    |                         |                                       |                    |                         |                                       |
| Earning assets                                                                         |                    |                         |                                       |                    |                         |                                       |
| Loans <sup>(2)</sup>                                                                   | \$ 1,512,451       | \$ 20,897               | 5.56%                                 | \$ 1,373,988       | \$ 20,134               | 5.88%                                 |
| Securities available-for-sale                                                          | 486,742            | 3,872                   | 3.20%                                 | 382,385            | 3,747                   | 3.93%                                 |
| Securities held-to-maturity                                                            | 3,477              | 63                      | 7.29%                                 | 4,321              | 90                      | 8.35%                                 |
| Interest-bearing deposits                                                              | 67,129             | 72                      | 0.43%                                 | 174,776            | 100                     | 0.23%                                 |
| Total earning assets                                                                   | 2,069,799          | 24,904                  | 4.84%                                 | 1,935,470          | 24,071                  | 4.99%                                 |
| Other assets                                                                           | 290,768            |                         |                                       | 261,221            |                         |                                       |
| Total assets                                                                           | \$ 2,360,567       |                         |                                       | \$ 2,196,691       |                         |                                       |
| <b>Liabilities</b>                                                                     |                    |                         |                                       |                    |                         |                                       |
| Interest-bearing deposits                                                              |                    |                         |                                       |                    |                         |                                       |
| Demand deposits                                                                        | \$ 296,647         | \$ 43                   | 0.06%                                 | \$ 279,912         | \$ 113                  | 0.16%                                 |
| Savings deposits                                                                       | 421,331            | 119                     | 0.11%                                 | 414,439            | 241                     | 0.23%                                 |
| Time deposits                                                                          | 719,570            | 2,198                   | 1.23%                                 | 691,941            | 2,919                   | 1.69%                                 |
| Total interest-bearing deposits                                                        | 1,437,548          | 2,360                   | 0.66%                                 | 1,386,292          | 3,273                   | 0.95%                                 |
| Borrowings                                                                             |                    |                         |                                       |                    |                         |                                       |
| Retail repurchase agreements                                                           | 74,651             | 110                     | 0.59%                                 | 81,736             | 141                     | 0.69%                                 |
| Wholesale repurchase agreements                                                        | 54,194             | 469                     | 3.48%                                 | 50,000             | 468                     | 3.75%                                 |
| FHLB advances and other borrowings                                                     | 174,629            | 1,759                   | 4.05%                                 | 166,121            | 1,699                   | 4.10%                                 |
| Total borrowings                                                                       | 303,474            | 2,338                   | 3.10%                                 | 297,857            | 2,308                   | 3.11%                                 |
| Total interest-bearing liabilities                                                     | 1,741,022          | 4,698                   | 1.09%                                 | 1,684,149          | 5,581                   | 1.33%                                 |
| Noninterest-bearing demand deposits                                                    | 270,065            |                         |                                       | 219,402            |                         |                                       |
| Other liabilities                                                                      | 25,486             |                         |                                       | 1,666              |                         |                                       |
| Total liabilities                                                                      | 2,036,573          |                         |                                       | 1,905,217          |                         |                                       |
| Stockholders' equity                                                                   | 323,994            |                         |                                       | 291,474            |                         |                                       |
| Total liabilities and stockholders' equity                                             | \$ 2,360,567       |                         |                                       | \$ 2,196,691       |                         |                                       |
| Net interest income, tax equivalent                                                    |                    | \$ 20,206               |                                       |                    | \$ 18,490               |                                       |
| Net interest rate spread <sup>(3)</sup>                                                |                    |                         | 3.75%                                 |                    |                         | 3.66%                                 |
| Net interest margin <sup>(4)</sup>                                                     |                    |                         | 3.93%                                 |                    |                         | 3.83%                                 |

(1)

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

- (2) Nonaccrual loans are included in average balances outstanding but with no related interest income during the period of nonaccrual.
- (3) Represents the difference between the yield on earning assets and cost of funds.
- (4) Represents tax equivalent net interest income divided by average earning assets.

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| Average Balance Sheets and Net Interest Income Analysis<br>Six Months Ended June 30, |                    |                         |                                       |                    |                         |                                       |
|--------------------------------------------------------------------------------------|--------------------|-------------------------|---------------------------------------|--------------------|-------------------------|---------------------------------------|
|                                                                                      | 2012               |                         |                                       | 2011               |                         |                                       |
| (Amounts in thousands)                                                               | Average<br>Balance | Interest <sup>(1)</sup> | Average Yield/<br>Rate <sup>(1)</sup> | Average<br>Balance | Interest <sup>(1)</sup> | Average Yield/<br>Rate <sup>(1)</sup> |
| <b>Assets</b>                                                                        |                    |                         |                                       |                    |                         |                                       |
| Earning assets                                                                       |                    |                         |                                       |                    |                         |                                       |
| Loans <sup>(2)</sup>                                                                 | \$ 1,453,348       | \$ 40,304               | 5.58%                                 | \$ 1,378,233       | \$ 40,629               | 5.94%                                 |
| Securities available-for-sale                                                        | 482,550            | 7,729                   | 3.22%                                 | 424,104            | 8,544                   | 4.06%                                 |
| Securities held-to-maturity                                                          | 3,357              | 125                     | 7.49%                                 | 4,432              | 185                     | 8.42%                                 |
| Interest-bearing deposits                                                            | 54,827             | 111                     | 0.41%                                 | 141,662            | 169                     | 0.24%                                 |
| Total earning assets                                                                 | 1,994,082          | 48,269                  | 4.87%                                 | 1,948,431          | 49,527                  | 5.13%                                 |
| Other assets                                                                         | 273,203            |                         |                                       | 263,457            |                         |                                       |
| Total assets                                                                         | \$ 2,267,285       |                         |                                       | \$ 2,211,888       |                         |                                       |
| <b>Liabilities</b>                                                                   |                    |                         |                                       |                    |                         |                                       |
| Interest-bearing deposits                                                            |                    |                         |                                       |                    |                         |                                       |
| Demand deposits                                                                      | \$ 289,767         | \$ 74                   | 0.05%                                 | \$ 275,781         | \$ 324                  | 0.24%                                 |
| Savings deposits                                                                     | 408,459            | 229                     | 0.11%                                 | 421,046            | 598                     | 0.29%                                 |
| Time deposits                                                                        | 676,980            | 4,462                   | 1.33%                                 | 705,632            | 6,231                   | 1.78%                                 |
| Total interest-bearing deposits                                                      | 1,375,206          | 4,765                   | 0.70%                                 | 1,402,459          | 7,153                   | 1.03%                                 |
| Borrowings                                                                           |                    |                         |                                       |                    |                         |                                       |
| Federal funds purchased                                                              | 985                | 2                       | 0.41%                                 |                    |                         | 0.00%                                 |
| Retail repurchase agreements                                                         | 73,411             | 224                     | 0.61%                                 | 85,191             | 314                     | 0.74%                                 |
| Wholesale repurchase agreements                                                      | 52,097             | 938                     | 3.62%                                 | 50,000             | 935                     | 3.77%                                 |
| FHLB advances and other borrowings                                                   | 170,252            | 3,474                   | 4.10%                                 | 172,117            | 3,494                   | 4.09%                                 |
| Total borrowings                                                                     | 296,745            | 4,638                   | 3.14%                                 | 307,308            | 4,743                   | 3.11%                                 |
| Total interest-bearing liabilities                                                   | 1,671,951          | 9,403                   | 1.13%                                 | 1,709,767          | 11,896                  | 1.40%                                 |
| Noninterest-bearing demand deposits                                                  | 254,464            |                         |                                       | 215,669            |                         |                                       |
| Other liabilities                                                                    | 23,476             |                         |                                       | 2,995              |                         |                                       |
| Total liabilities                                                                    | 1,949,891          |                         |                                       | 1,928,431          |                         |                                       |
| Stockholders' equity                                                                 | 317,394            |                         |                                       | 283,457            |                         |                                       |
| Total liabilities and stockholders' equity                                           | \$ 2,267,285       |                         |                                       | \$ 2,211,888       |                         |                                       |
| Net interest income, tax equivalent                                                  |                    | \$ 38,866               |                                       |                    | \$ 37,631               |                                       |
| Net interest rate spread <sup>(3)</sup>                                              |                    |                         | 3.74%                                 |                    |                         | 3.73%                                 |
| Net interest margin <sup>(4)</sup>                                                   |                    |                         | 3.92%                                 |                    |                         | 3.89%                                 |

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- (1) Fully taxable equivalent at the rate of 35% ( FTE ). The FTE basis adjusts for the tax benefits of income on certain tax exempt loans and investments using the federal statutory rate of 35% for each period presented. The Company believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and nontaxable amounts.
- (2) Nonaccrual loans are included in average balances outstanding but with no related interest income during the period of nonaccrual.
- (3) Represents the difference between the yield on earning assets and cost of funds.
- (4) Represents tax equivalent net interest income divided by average earning assets.

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

|                                               | Three Months Ended                                                  |          |                 |          | Six Months Ended                                                    |            |                 |          |
|-----------------------------------------------|---------------------------------------------------------------------|----------|-----------------|----------|---------------------------------------------------------------------|------------|-----------------|----------|
|                                               | June 30, 2012 Compared to 2011<br>Dollar Increase (Decrease) due to |          |                 |          | June 30, 2012 Compared to 2011<br>Dollar Increase (Decrease) due to |            |                 |          |
| (Amounts in thousands)                        | Volume                                                              | Rate     | Rate/<br>Volume | Total    | Volume                                                              | Rate       | Rate/<br>Volume | Total    |
| Interest earned on:                           |                                                                     |          |                 |          |                                                                     |            |                 |          |
| Loans (FTE)                                   | \$ 1,017                                                            | \$ (603) | \$ 349          | \$ 763   | \$ 2,214                                                            | \$ (2,521) | \$ (18)         | \$ (325) |
| Securities available-for-sale (FTE)           | 513                                                                 | (358)    | (30)            | 125      | 1,178                                                               | (1,775)    | (218)           | (815)    |
| Securities held-to-maturity (FTE)             | (9)                                                                 | (6)      | (12)            | (27)     | (45)                                                                | (20)       | 5               | (60)     |
| Interest-bearing deposits with other banks    | (31)                                                                | 44       | (41)            | (28)     | (104)                                                               | 117        | (71)            | (58)     |
| Total interest earning assets                 | 1,490                                                               | (923)    | 266             | 833      | 3,243                                                               | (4,199)    | (302)           | (1,258)  |
| Interest paid on:                             |                                                                     |          |                 |          |                                                                     |            |                 |          |
| Demand deposits                               | 3                                                                   | (36)     | (37)            | (70)     | 16                                                                  | (254)      | (12)            | (250)    |
| Savings deposits                              | 2                                                                   | (62)     | (62)            | (122)    | (18)                                                                | (364)      | 13              | (369)    |
| Time deposits                                 | 58                                                                  | (407)    | (374)           | (721)    | (253)                                                               | (1,597)    | 81              | (1,769)  |
| Federal funds purchased                       |                                                                     |          |                 |          |                                                                     |            | 2               | 2        |
| Retail repurchase agreements                  | (6)                                                                 | (10)     | (14)            | (31)     | (43)                                                                | (55)       | 8               | (90)     |
| Wholesale repurchase agreements               | 20                                                                  | (18)     | (1)             | 1        | 39                                                                  | (37)       | 1               | 3        |
| FHLB advances and other borrowings            | 44                                                                  | (15)     | 31              | 60       | (38)                                                                | 8          | 10              | (20)     |
| Total interest-bearing liabilities            | 121                                                                 | (548)    | (456)           | (883)    | (297)                                                               | (2,299)    | 103             | (2,493)  |
| Change in net interest income, tax equivalent | \$ 1,369                                                            | \$ (375) | \$ 722          | \$ 1,716 | \$ 3,540                                                            | \$ (1,900) | \$ (405)        | \$ 1,235 |

**Provision for Loan Losses**

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses was reduced \$1.46 million for the second quarter of 2012 compared with the second quarter of 2011, which was primarily due to a continued general downward trend in net charge-offs. There was no provision for loan losses recorded during the period related to the acquired loan portfolios. We incurred net charge-offs of \$1.25 million for the quarter ended June 30, 2012, compared with \$3.08 million for the same quarter of 2011. Annualized net charge-offs as a percentage of average non-covered loans was 0.38% for the quarter ended June 30, 2012, compared with 0.89% for the same quarter of 2011.

The provision for loan losses was reduced \$2.15 million for first half of 2012 compared with the first half of 2011, which was primarily due to a continued general downward trend in net charge-offs. We incurred net charge-offs of \$2.58 million for the six months ended June 30, 2012, compared with \$4.69 million for the same period of 2011. Annualized net charge-offs as a percentage of average non-covered loans was 0.38% for the six months ended June 30, 2012, compared with 0.69% for the same period of 2011.

**Noninterest Income**

Noninterest income, consisting of all revenues not included in interest and fee income related to earning assets, decreased \$3.02 million, or 26.58%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. Exclusive of the impact of other-than-temporary impairment (OTTI) charges and the loss or gain on the sale of securities, noninterest income increased \$213 thousand, or 2.62%, to \$8.35 million for the quarter ended June 30, 2012, compared with \$8.14 million for the same quarter of 2011.

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Wealth management revenues, including fees and commissions for trust services and investment advisory services, remained stable, increasing \$10 thousand for the quarter ended June 30, 2012, compared with the same quarter of 2011. Service charges on deposit accounts decreased \$24 thousand for the quarter ended June 30, 2012, compared with the same quarter of

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2011. Other service charges, commissions, and fees increased \$103 thousand, or 7.05%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. Insurance commissions decreased \$225 thousand, or 14.41%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. The commissions earned for the second quarter of 2011 include the agency offices sold as part of strategic realignment during the third quarter of 2011.

Other operating income increased \$349 thousand, or 41.85%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. The increase was primarily due to earn-out payments received for insurance agencies. We incurred no OTTI charges for the quarters ended June 30, 2012 and 2011. We incurred a net loss on sale of securities of \$9 thousand for the quarter ended June 30, 2012, which was a \$3.23 million decrease from the net gain on sale of securities of \$3.22 million for the same quarter of 2011. See Note 4, Investment Securities, of the Notes to Condensed Consolidated Financial Statements in Item 1, Financial Statements, herein for additional information.

Noninterest income decreased \$4.53 million, or 21.70%, for the six months ended June 30, 2012, compared with the same period of 2011. Exclusive of the impact of OTTI charges and the gain on the sale of securities, noninterest income remained relatively stable, decreasing only \$37 thousand, to \$16.29 million for the six months ended June 30, 2012, compared with \$16.33 million for the same period of 2011.

Wealth management revenues remained stable, increasing \$10 thousand for the six months ended June 30, 2012, compared with the same period of 2011. Service charges on deposit accounts decreased \$42 thousand for the six months ended June 30, 2012, compared with the same period of 2011. Other service charges, commissions, and fees increased \$282 thousand, or 9.84%, for the six months ended June 30, 2012, compared with the same period of 2011. Insurance commissions decreased \$592 thousand, or 16.89%, for the six months ended June 30, 2012, compared with the same period of 2011. Profit-sharing commissions from our carriers were lower in the first quarter of 2012 compared with the first quarter of 2011 as a result of higher loss experience on our customers' policies. Further, the commissions earned for the first half of 2011 include the agency offices sold as part of strategic realignment during the third quarter of 2011.

Other operating income increased \$305 thousand, or 17.43%, for the six months ended June 30, 2012, compared with the same period of 2011. The increase was primarily due to earn-out payments received for insurance agencies. We incurred no OTTI charges for the six months ended June 30, 2012, compared to \$527 thousand for the same period of 2011, which were related to a non-Agency mortgage-backed security ( MBS ). The net gain on sale of securities decreased \$5.02 million, or 99.17%, for the six months ended June 30, 2012, compared with the same period of 2011. See Note 4, Investment Securities, of the Notes to Condensed Consolidated Financial Statements in Item 1, Financial Statements, herein for additional information.

### ***Noninterest Expense***

Noninterest expense increased \$2.39 million, or 13.50%, for the second quarter of 2012 compared with the second quarter of 2011. Salaries and employee benefits increased \$207 thousand, or 2.38%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. The Peoples and Waccamaw acquisitions accounted for an increase in salaries and employee benefits of \$100 thousand and \$392 thousand, respectively, during the second quarter of 2012. At June 30, 2012, we had 771 full-time equivalent employees compared to 673 at June 30, 2011. The Peoples and Waccamaw acquisitions resulted in the addition of 32 and 97 full-time equivalent employees, respectively, for the period ended June 30, 2012. Occupancy, furniture, and equipment expense increased \$152 thousand, or 6.14%, to \$2.63 million for the quarter ended June 30, 2012, compared with \$2.48 million for the same quarter of 2011 as a result of the Peoples and Waccamaw acquisitions.

FDIC premiums and assessments decreased \$124 thousand, or 29.95%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. We incurred \$3.42 million in merger related costs for the quarter ended June 30, 2012, in connection with the Peoples and Waccamaw acquisitions. Other operating expense decreased \$1.19 million, or 20.13%, for the quarter ended June 30, 2012, compared with the same quarter of 2011. The decrease in other operating expense was primarily due to a \$1.47 million decrease in expenses and losses associated with other real estate owned ( OREO ) to \$270 thousand for the second quarter of 2012, compared with \$1.74 million for the second quarter of 2011. Also contributing to the change in other operating expense between the second quarters of 2012 and 2011 were decreases in non-merger related consulting fees and regulatory assessments of \$270 thousand and \$146 thousand, respectively, offset by increases in legal expenses, services fees, and communication expense of \$433 thousand, \$200 thousand, and \$133 thousand, respectively.

Noninterest expense increased \$524 thousand, or 1.46%, for the first half of 2012 compared with the first half of 2011. Salaries and employee benefits decreased \$700 thousand, or 3.93%, for the six months ended June 30, 2012, compared with the same period of 2011. The Peoples and Waccamaw acquisitions accounted for an increase in salaries and employee benefits of \$100 thousand and \$392 thousand, respectively, during the first half of 2012. Exclusive of the Peoples and Waccamaw acquisitions, salaries and employee benefits decreased \$1.19 million, or 6.69%, for the first half of 2012 compared with the first half of 2011. Occupancy, furniture, and equipment expense decreased \$73 thousand, or 1.45%, to \$4.97 million for the six months ended June 30, 2012, compared with \$5.04 million for the same period of 2011.



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FDIC premiums and assessments decreased \$680 thousand, or 52.63%, for the six months ended June 30, 2012, compared with the same period of 2011, which was primarily due to the FDIC's change in assessment methodology for deposit insurance during 2011. We incurred \$3.58 million in merger related costs for the six months ended June 30, 2012, in connection with the Peoples and Waccamaw acquisitions. Other operating expense decreased \$1.04 million, or 9.71%, for the six months ended June 30, 2012, compared with the same period of 2011. The decrease in other operating expense was primarily due to a \$907 thousand decrease in expenses and losses associated with OREO to \$1.09 million for the first half of 2012, compared with \$2.00 million for the first half of 2011. Also contributing to the change in other operating expense between the first half of 2012 compared with 2011 were decreases in regulatory assessments and non-merger related consulting fees of \$212 thousand and \$210 thousand, respectively, offset by increases in legal expenses of \$447 thousand.

### ***Income Tax Expense***

Income tax as a percentage of pretax income may vary significantly from statutory rates due to permanent differences, which are items of income and expense excluded by law from the calculation of taxable income. Our most significant permanent differences include income on municipal securities, which are exempt from federal income tax; certain dividend payments, which are deductible; and increases in the cash surrender value of life insurance policies. Consolidated income taxes were \$2.00 million for the second quarter of 2012 compared to \$2.57 million for the second quarter of 2011. The effective tax expense rates for the quarters ended June 30, 2012 and 2011 were 32.87% and 30.99%, respectively. Consolidated income taxes were \$4.85 million for the first half of 2012 compared to \$4.92 million for the first half of 2011. The effective tax expense rates for the six months ended June 30, 2012 and 2011 were 32.48% and 30.00%, respectively. The increases in the effective tax rates are largely due to an increase in taxable revenues as a percent of net earnings and decrease in the relative amounts of nontaxable revenues.

### ***Financial Condition***

Total assets were \$2.81 billion as of June 30, 2012, an increase of \$645.53 million, or 29.82%, compared with \$2.16 billion at December 31, 2011. Total liabilities were \$2.47 billion as of June 30, 2012, an increase of \$609.55 million, or 32.79%, compared with \$1.86 billion at December 31, 2011. Asset and liability increases were primarily due to the Peoples and Waccamaw acquisitions. As of June 30, 2012, our book value per as-converted common share was \$16.03, an increase of \$0.07, compared with December 31, 2011.

### ***Investment Securities***

#### ***Held-to-Maturity Securities***

Held-to-maturity securities as of June 30, 2012, decreased \$2.20 million, or 62.89%, compared with December 31, 2011. The market value of securities held-to-maturity as a percentage of amortized cost was 101.78% at June 30, 2012, compared with 101.20% at December 31, 2011.

#### ***Available-for-Sale Securities***

Available-for-sale securities as of June 30, 2012, increased \$44.18 million, or 9.16%, compared with December 31, 2011. The market value of securities available-for-sale as a percentage of amortized cost improved to 99.33% at June 30, 2012, compared with 98.13% at December 31, 2011, as a result of improved pricing on certain issues, particularly single issued trust preferred securities.

During the second quarters of 2012 and 2011, we recognized no OTTI charges in earnings. During the first half of 2012, we recognized no OTTI charges in earnings compared to \$527 thousand during the first half of 2011, which were related to a non-Agency MBS. We incurred no OTTI charges on equity securities during the three and six months ended June 30, 2012, and 2011. See Note 4, Investment Securities, of the Notes to Condensed Consolidated Financial Statements in Item 1, Financial Statements, herein for additional information.

### ***Loan Portfolio***

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

Loans held for sale as of June 30, 2012, decreased \$4.64 million, or 79.74% compared with December 31, 2011. Loans held for sale consist of mortgage loans sold on a best efforts basis into the secondary loan market; accordingly, we do not retain



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the interest rate risk involved in these commitments. The gross notional amount of outstanding commitments related to secondary market mortgage loans at June 30, 2012, was \$16.60 million for 104 loans compared to \$9.15 million for 53 loans at December 31, 2011.

*Loans Held for Investment*

Loans held for investment as of June 30, 2012, increased \$411.02 million, or 29.44%, compared with December 31, 2011, and \$433.15 million, or 31.53%, compared with June 30, 2011. The increase during the second quarter of 2012 was due to the Peoples and Waccamaw acquisitions. The average loan to deposit ratio was 88.57% for the second quarter of 2012 compared to 89.45% the fourth quarter of 2011, and 85.57% for the second quarter of 2011. The held for investment portfolio continues to be diversified among loan types and industry segments. The following table details the loan portfolio for the dates indicated:

| (Amounts in thousands)           | June 30, 2012 |         | December 31, 2011 |         | June 30, 2011 |         |
|----------------------------------|---------------|---------|-------------------|---------|---------------|---------|
|                                  | Amount        | Percent | Amount            | Percent | Amount        | Percent |
| Covered loans                    | \$ 238,777    | 13.21%  | \$                | 0.00%   | \$            | 0.00%   |
| Non-covered loans                |               |         |                   |         |               |         |
| Commercial loans                 |               |         |                   |         |               |         |
| Construction commercial          | 20,877        | 1.16%   | 35,482            | 2.54%   | 34,966        | 2.55%   |
| Land development                 | 6,549         | 0.36%   | 2,902             | 0.21%   | 4,694         | 0.34%   |
| Other land loans                 | 26,571        | 1.47%   | 23,384            | 1.67%   | 23,354        | 1.70%   |
| Commercial and industrial        | 99,364        | 5.50%   | 91,939            | 6.58%   | 92,891        | 6.76%   |
| Multi-family residential         | 86,040        | 4.76%   | 77,050            | 5.52%   | 78,163        | 5.69%   |
| Single family non-owner occupied | 140,684       | 7.79%   | 106,743           | 7.65%   | 109,191       | 7.95%   |
| Non-farm, non-residential        | 453,820       | 25.12%  | 336,005           | 24.07%  | 333,475       | 24.27%  |
| Agricultural                     | 1,643         | 0.09%   | 1,374             | 0.10%   | 1,677         | 0.12%   |
| Farmland                         | 38,423        | 2.13%   | 37,161            | 2.66%   | 37,227        | 2.71%   |
| Total commercial loans           | 873,971       | 48.38%  | 712,040           | 51.00%  | 715,638       | 52.09%  |
| Consumer real estate loans       |               |         |                   |         |               |         |
| Home equity lines                | 115,843       | 6.41%   | 111,387           | 7.98%   | 111,995       | 8.15%   |
| Single family owner occupied     | 466,450       | 25.81%  | 473,067           | 33.89%  | 451,336       | 32.85%  |
| Owner occupied construction      | 30,417        | 1.68%   | 19,577            | 1.40%   | 18,062        | 1.31%   |
| Total consumer real estate loans | 612,710       | 33.90%  | 604,031           | 43.27%  | 581,393       | 42.31%  |
| Consumer and other loans         |               |         |                   |         |               |         |
| Consumer loans                   | 75,781        | 4.19%   | 67,129            | 4.81%   | 64,692        | 4.71%   |
| Other                            | 5,850         | 0.32%   | 12,867            | 0.92%   | 12,221        | 0.89%   |
| Total consumer and other loans   | 81,631        | 4.51%   | 79,996            | 5.73%   | 76,913        | 5.60%   |
| Total non-covered loans          | 1,568,312     | 86.80%  | 1,396,067         | 100.00% | 1,373,944     | 100.00% |
| Total loans held for investment  | \$ 1,807,089  | 100.01% | \$ 1,396,067      | 100.00% | \$ 1,373,944  | 100.00% |
| Loans held for sale              | \$ 1,179      |         | \$ 5,820          |         | \$ 920        |         |

*Allowance for Loan Losses*

The allowance for loan losses is maintained at a level management deems sufficient to absorb probable loan losses inherent in the loan portfolio. The allowance is increased by charges to earnings in the form of provisions for loan losses and recoveries of prior loan charge-offs and decreased by loans charged off. The determination of the allowance requires management to make various assumptions and judgments. As a result, actual loan losses may differ materially from management's determination if actual conditions differ significantly from the assumptions utilized. The ultimate adequacy of the allowance for loan losses is dependent upon a variety of factors beyond our control including, among other things, the economy, changes in interest rates, and the view of regulatory authorities toward loan classifications. Management considers the allowance to be adequate based upon analysis of the portfolio as of June 30, 2012; however, no assurance can be made that additions to the

allowance for loan losses will not be required in future periods.

Qualitative risk factors for the loan portfolio remain high which reflect the elevated risk of inherent loan losses due to high unemployment, effects of the recent recession, and devaluations of various categories of collateral. Significant stress continues in commercial and residential real estate markets, resulting in significant declines in real estate valuations. Decreases

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in real estate values adversely affect the value of property used as collateral for loans, including loans we originated. In addition, adverse changes in the economy, particularly continued high rates of unemployment, may have a negative effect on the ability of our borrowers to make timely loan payments. A further increase in loan delinquencies could adversely impact loan loss experience, causing potential increases in the provision and allowance for loan losses.

Our allowance for loan losses for non-covered loans totaled \$26.17 million at June 30, 2012, \$26.21 million at December 31, 2011, and \$26.48 million at June 30, 2011. The allowance for loan losses for non-covered loans as a percentage of non-covered loans held for investment was 1.67% at June 30, 2012, 1.88% at December 31, 2011, and 1.93% at June 30, 2011. As a result of stable credit metrics and the general downward trend in net charge-offs over recent quarters, management deemed the reduced allowance and provision for loan losses as adequate and directionally consistent. Further, improving charge-off ratios reduced the quantitative estimate of probable losses in the allowance for loan loss methodology. There was no allowance for covered loans as of June 30, 2012.

The following table details the allowance for loan loss activity for non-covered loans and related information for the three and six months ended June 30, 2012 and 2011.

|                                             | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                             | 2012                           | 2011      | 2012                         | 2011      |
| <i>(Amounts in thousands)</i>               |                                |           |                              |           |
| Beginning balance                           | \$ 25,800                      | \$ 26,482 | \$ 26,205                    | \$ 26,482 |
| Provision for loan losses                   | 1,620                          | 3,079     | 2,542                        | 4,691     |
| Charge-offs                                 | (1,612)                        | (3,456)   | (3,174)                      | (5,483)   |
| Recoveries                                  | 363                            | 377       | 598                          | 792       |
| Net charge-offs                             | (1,249)                        | (3,079)   | (2,576)                      | (4,691)   |
| Ending balance                              | \$ 26,171                      | \$ 26,482 | \$ 26,171                    | \$ 26,482 |
| <b>Non-covered loans</b>                    |                                |           |                              |           |
| Annualized net charge-offs to average loans | 0.38%                          | 0.90%     | 0.38%                        | 0.69%     |
| Allowance for loan losses to total loans    | 1.67%                          | 1.93%     | 1.67%                        | 1.93%     |

**Table of Contents****Risk Elements**

Nonperforming assets consist of loans accounted for on a nonaccrual basis, accruing loans contractually past due 90 days or more, unseasoned troubled debt restructurings ( TDRs ), and OREO. Loans acquired through business combinations, for which a discount exists, are not considered to be nonaccrual as a result of the accretion of the discount based on the expected cash flow of the loans. The following table summarizes the components of nonperforming assets and presents additional detail for nonperforming and restructured loans for the periods indicated:

| <i>(Amounts in thousands)</i>                     | <b>June 30, 2012</b> | <b>December 31, 2011</b> | <b>June 30, 2011</b> |
|---------------------------------------------------|----------------------|--------------------------|----------------------|
| <b>Non-covered loans</b>                          |                      |                          |                      |
| Nonaccrual loans                                  | \$ 27,947            | \$ 24,487                | \$ 22,037            |
| Accruing loans past due 90 days or more           |                      |                          |                      |
| TDRs <sup>(1)</sup>                               | 469                  | 600                      | 878                  |
| Total nonperforming loans                         | 28,416               | 25,087                   | 22,915               |
| OREO not covered under FDIC loss share agreements | 4,938                | 5,914                    | 5,585                |
| Total nonperforming assets                        | \$ 33,354            | \$ 31,001                | \$ 28,500            |
| <b>Covered loans</b>                              |                      |                          |                      |
| Nonaccrual loans                                  | \$                   | \$                       | \$                   |
| Accruing loans past due 90 days or more           |                      |                          |                      |
| Total nonperforming loans                         |                      |                          |                      |
| OREO covered under FDIC loss share agreements     | 5,325                |                          |                      |
| Total nonperforming assets                        | \$ 5,325             | \$                       | \$                   |
| <b>Total loans</b>                                |                      |                          |                      |
| Nonaccrual loans                                  | \$ 27,947            | \$ 24,487                | \$ 22,037            |
| Accruing loans past due 90 days or more           |                      |                          |                      |
| TDRs <sup>(1)</sup>                               | 469                  | 600                      | 878                  |
| Total nonperforming loans                         | 28,416               | 25,087                   | 22,915               |
| OREO                                              | 10,263               | 5,914                    | 5,585                |
| Total nonperforming assets                        | \$ 38,679            | \$ 31,001                | \$ 28,500            |
| Performing TDRs <sup>(2)</sup>                    | \$ 6,995             | \$ 8,854                 | \$ 16,233            |
| Total TDRs <sup>(3)</sup>                         | \$ 7,464             | \$ 9,454                 | \$ 17,111            |
| <b>Non-covered loans</b>                          |                      |                          |                      |
| Nonperforming loans to total loans                | 1.81%                | 1.80%                    | 1.67%                |
| Nonperforming assets to total assets              | 1.30%                | 1.43%                    | 1.29%                |
| Allowance for loan losses to nonperforming loans  | 92.10%               | 104.46%                  | 115.57%              |
| <b>Total loans (includes covered assets)</b>      |                      |                          |                      |
| Nonperforming loans to total loans                | 1.57%                | 1.80%                    | 1.67%                |
| Nonperforming assets to total assets              | 1.38%                | 1.43%                    | 1.29%                |
| Allowance for loan losses to nonperforming loans  | 92.10%               | 104.46%                  | 115.57%              |

(1) TDRs restructured within the past six months, excluding nonaccrual TDRs of \$4.76 million, \$3.04 million, and \$46 thousand at June 30, 2012, December 31, 2012, and June 30, 2011, respectively.

(2)

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TDRs with six months or more of satisfactory payment performance, excluding nonaccrual TDRs of \$20 thousand, \$227 thousand, and \$821 thousand at June 30, 2012, December 31, 2011, and June 30, 2011, respectively.

- (3) Performing and nonperforming TDRs, excluding nonaccrual TDRs of \$4.78 million, \$3.27 million, and \$867 thousand at June 30, 2012, December 31, 2012, and June 30, 2011, respectively.

Non-covered nonperforming assets totaled \$33.35 million at June 30, 2012, a \$2.35 million increase over December 31, 2011. Non-covered nonperforming assets as a percentage of total non-covered assets were 1.30% at June 30, 2012, 1.43% at December 31, 2011, and 1.29% at June 30, 2011.

Non-covered nonaccrual loans totaled \$27.95 million at June 30, 2012, \$24.49 million at December 31, 2011, and \$22.04 million at June 30, 2011. As of June 30, 2012, non-covered nonaccrual loans were largely attributed to the following loan classes: non-farm, non-residential (34.75%); single family owner occupied (30.15%); single family non-owner occupied (15.58%); and commercial and industrial (15.78%). Approximately \$1.50 million, or 5.36%, of non-covered nonaccrual loans

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are attributed to loans acquired in business combinations. Certain loans included in the nonaccrual category have been written down to the estimated realizable value or assigned specific reserves within the allowance for loan losses based upon management's estimate of loss at ultimate resolution.

When restructuring loans for borrowers experiencing financial difficulty, the Company generally makes concessions in interest rates, loan terms and/or amortization terms. Certain TDRs are classified as nonperforming at time of restructuring and are returned to performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs. Accruing TDRs totaled \$7.46 million at June 30, 2012, \$9.45 million at December 31, 2011, and \$17.98 million at June 30, 2011. Accruing nonperforming TDRs amounted to \$469 thousand, or 6.29%, of total accruing TDRs as of June 30, 2012, as compared to 6.35% and 5.13% of accruing TDRs at December 31, 2011, and June 30, 2011, respectively. The allowance for loan losses attributed to TDRs totaled \$675 thousand at June 30, 2012, \$1.14 million at December 31, 2011, and \$1.61 million at June 30, 2011.

Ongoing activity within the classification and categories of nonperforming loans include collections on delinquencies, foreclosures, loan restructurings, and movements into or out of the nonperforming classification as a result of changing economic conditions, borrower financial capacity, or resolution efforts. There continues to be no accruing loans contractually past due 90 days or more as of June 30, 2012. Non-covered OREO, which is carried at the lesser of estimated net realizable value or cost, totaled \$4.94 million as of June 30, 2012, a decrease of \$976 thousand, or 16.50%, compared with December 31, 2011. The following table details activity within OREO for the periods indicated:

| <i>(Amounts in thousands)</i> | <b>June 30, 2012</b> |                |              |
|-------------------------------|----------------------|----------------|--------------|
|                               | <b>Non-covered</b>   | <b>Covered</b> | <b>Total</b> |
| Beginning balance, January 1  | \$ 5,914             | \$             | \$ 5,914     |
| Acquired                      |                      | 5,388          | 5,388        |
| Additions                     | 3,311                |                | 3,311        |
| Disposals                     | (3,593)              |                | (3,593)      |
| Valuation adjustments         | (694)                | (63)           | (757)        |
| Ending balance, June 30       | \$ 4,938             | \$ 5,325       | \$ 10,263    |

| <i>(Amounts in thousands)</i> | <b>June 30, 2011</b> |
|-------------------------------|----------------------|
| Beginning balance, January 1  | \$ 4,910             |
| Additions                     | 5,065                |
| Disposals                     | (3,231)              |
| Valuation adjustments         | (1,159)              |
| Ending balance, June 30       | \$ 5,585             |

Covered OREO is pursuant to the FDIC Loss Share Agreements discussed in Note 3, Business Combinations, of the Notes to Condensed Consolidated Financial Statements in Item 1, Financial Statements, herein, and is presented net of the related fair value discount. As of June 30, 2012, non-covered OREO consisted of 48 properties and had an average holding period of 7 months. During the second quarter and first half of 2012, the net loss on OREO totaled \$194 thousand and \$844 thousand, respectively.

Non-covered delinquent loans, comprised of loans 30 days or more past due and nonaccrual loans, totaled \$38.60 million as of June 30, 2012, an increase of \$1.94 million, or 5.29%, compared with December 31, 2011. The Peoples and Waccamaw acquisitions resulted in an addition of \$1.84 million to non-covered delinquent loans. Non-covered delinquent loans as a percentage of total non-covered loans measured 2.46% at June 30, 2012, of which loans 30 to 89 days past due comprised 0.68% and nonaccrual loans comprised 1.78%. Non-covered nonperforming loans, comprised of nonaccrual loans and unseasoned TDRs, as a percentage of total non-covered loans were 1.80% at June 30, 2012, 1.80% at December 31, 2011, and 1.67% at June 30, 2011.

**Deposits**

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Total deposits as of June 30, 2012, increased \$561.74 million, or 36.39%, compared with December 31, 2011. Noninterest-bearing deposits and interest-bearing demand deposits as of June 30, 2012, increased \$100.63 million and \$60.53 million, respectively, compared with December 31, 2011. Savings deposits, which include money market accounts and savings accounts, as of June 30, 2012, increased \$99.81 million compared with December 31, 2011. Time deposits as of June 30, 2012, increased \$300.77 million compared with December 31, 2011. Increases in deposit accounts were primarily due to the Peoples and Waccamaw acquisitions completed during the second quarter of 2012.

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Our borrowings consist primarily of securities sold under agreements to repurchase and FHLB advances. Short-term borrowings consist of overnight federal funds purchased and repurchase agreements. There were no federal funds purchased at June 30, 2012, or December 31, 2011. Retail repurchase agreements increased \$10.96 million, or 13.87%, as of June 30, 2012, compared with December 31, 2011. The balance of wholesale repurchase agreements increased \$8.20 million, or 16.39%, and the weighted average rate decreased 28 basis points as of June 30, 2012, compared with December 31, 2011. The balance and weighted average rate of FHLB advances, including convertible and callable borrowings, increased \$26.65 million and 57 basis points, respectively, as of June 30, 2012, compared with December 31, 2011. As of June 30, 2012, the FHLB advances had maturities between two months and nine years.

***Stockholders' Equity***

Total stockholders' equity was \$341.71 million as of June 30, 2012, an increase of \$35.98 million, or 11.77%, compared with \$305.73 million at December 31, 2011. During the second quarter we issued 2,157,005 shares of Common Stock for approximately \$26.47 million in connection with the Peoples acquisition. The change in stockholders' equity during the first half of 2012 was also due to net income of \$10.08 million, dividends declared on common and preferred stock of \$4.32 million, and an increase in accumulated other comprehensive income of \$3.62 million.

***Risk-Based Capital***

Risk-based capital guidelines promulgated by state and federal banking agencies weight balance sheet assets and off-balance sheet commitments based on inherent risks associated with the respective asset types. As of June 30, 2012, the Bank was deemed well capitalized under regulatory capital adequacy standards. Our Company's and the Bank's capital ratios are presented in the following table for the dates indicated. We expect the Tier 1 leverage ratio to decline for the third quarter of 2012 as a result of a full reporting period's impact of the addition of assets acquired from Peoples and Waccamaw.

|                                        | June 30, 2012 | December 31, 2011 |
|----------------------------------------|---------------|-------------------|
| <b>Total risk-based capital ratio</b>  |               |                   |
| First Community Bancshares, Inc.       | 15.06%        | 18.15%            |
| First Community Bank                   | 13.55%        | 16.12%            |
| <b>Tier 1 risk-based capital ratio</b> |               |                   |
| First Community Bancshares, Inc.       | 13.80%        | 16.89%            |
| First Community Bank                   | 12.30%        | 14.86%            |
| <b>Tier 1 leverage ratio</b>           |               |                   |
| First Community Bancshares, Inc.       | 11.23%        | 11.50%            |
| First Community Bank                   | 9.98%         | 10.08%            |

***Liquidity and Capital Resources***

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

As of June 30, 2012, we maintained liquidity in the form of unencumbered cash on hand and deposits with other financial institutions of \$156.17 million, unpledged available-for-sale securities of \$228.32 million, FHLB credit availability of \$445.89 million, and federal funds lines availability of \$114.51 million. Cash on hand and deposits with other financial institutions, as well as the FHLB, are immediately available for satisfaction of deposit withdrawals, customer credit needs, and our operations. Available-for-sale securities represent a secondary level of liquidity available for conversion to liquid funds in the event of extraordinary needs. Our approved lines of credit with correspondent banks are available as backup liquidity sources.

As a holding company, we do not conduct significant operations and our primary sources of liquidity are dividends upstreamed from the Bank and borrowings from outside sources. Banking regulations limit the amount of dividends that may



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be paid by the Bank. As of June 30, 2012, our liquid assets, including cash and investment securities, totaled \$23.76 million. Our cash reserves and investments, as well as management fee arrangements, provide adequate working capital to meet obligations and projected dividends to shareholders for the next twelve months. Additionally, we maintain a \$15.00 million unsecured, committed line of credit. There was no balance on the line as of June 30, 2012.

### ***Off-Balance Sheet Risk***

As of June 30, 2012, our off-balance sheet risk included \$234.64 million in commitments to extend credit and \$4.36 million in standby letters of credit and financial guarantees. Our exposure to credit loss in the event of nonperformance by other parties to financial instruments is represented by the contractual amount of those instruments.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

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

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

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

We have established policy limits for tolerance of interest rate risk in various interest rate scenarios. In addition, the policy addresses exposure limits to changes in the economic value of equity according to predefined policy guidelines. The most recent simulation indicates that current exposure to interest rate risk is within our defined policy limits.

The following table summarizes the impact of immediate and sustained rate shocks in the interest rate environment on net interest income and the economic value of equity. The model simulates plus 300 to minus 100 basis point changes from the base case rate simulation and illustrates the prospective effects of hypothetical interest rate changes over a twelve-month time period. This modeling technique, although useful, does not take into account all strategies that management might undertake in response to a sudden and sustained rate shock as depicted. Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other internal and external variables. As of June 30, 2012, the Federal Open Market Committee maintained a target range for federal funds of 0 to 25 basis points, rendering a complete downward shock of 200 basis points less meaningful; accordingly, downward rate scenarios are limited to minus 100 basis points. In the downward rate shocks presented, benchmark interest rates are assumed at levels with floors near 0%.



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| June 30, 2012                               |              |         |                |         |
|---------------------------------------------|--------------|---------|----------------|---------|
| (Amounts in thousands, except basis points) | Change<br>in |         | Change in      |         |
| Increase (Decrease) in                      | Net Interest | Percent | Economic Value | Percent |
| Interest Rates/Basis Points                 | Income       | Change  | of Equity      | Change  |
| 300                                         | \$ 18,175    | 21.4    | \$ 13,715      | 3.0     |
| 200                                         | 11,564       | 13.6    | 10,911         | 2.4     |
| 100                                         | 5,252        | 6.2     | 5,737          | 1.3     |
| (100)                                       | (987)        | (1.2)   | (15,305)       | (3.3)   |

| December 31, 2011                           |              |         |                |         |
|---------------------------------------------|--------------|---------|----------------|---------|
| (Amounts in thousands, except basis points) | Change<br>in |         | Change in      |         |
| Increase (Decrease) in                      | Net Interest | Percent | Economic Value | Percent |
| Interest Rates/Basis Points                 | Income       | Change  | of Equity      | Change  |
| 300                                         | \$ 8,881     | 13.0    | \$ (7,278)     | (2.4)   |
| 200                                         | 6,124        | 9.0     | (1,557)        | (0.5)   |
| 100                                         | 3,355        | 4.9     | 1,957          | 0.7     |
| (100)                                       | (826)        | (1.2)   | (19,977)       | (6.7)   |

During the next twelve months we have more assets than liabilities projected to reprice. As a result, projected net interest income will increase as benchmark rates increase. If benchmark interest rates decrease further than current levels, projected net interest income will decline.

**Impact of Inflation and Changing Prices**

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The primary effect of inflation on our operations is reflected in increased operating costs. In management's opinion, interest rates have a greater impact on our consolidated performance than do the effects of general levels of inflation. Interest rates do not necessarily fluctuate in the same direction or to the same extent as the price of goods and services.

**Item 4. Controls and Procedures**  
**Evaluation of Disclosure Controls and Procedures**

In connection with this report on Form 10-Q, we conducted an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of our disclosure controls and procedures pursuant to the Securities Exchange Act of 1934 (the Exchange Act ) Rule 13a-15(b). Based upon that evaluation, the CEO and CFO concluded that, as of June 30, 2012, our disclosure controls and procedures were effective.

Disclosure controls and procedures are Company controls and other procedures that are designed to ensure that information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

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

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

We assess the adequacy of our internal control over financial reporting quarterly and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2012, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

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

We are currently a defendant in various legal actions and asserted claims in the normal course of business. Although our Company and legal counsel are unable to assess the ultimate outcome of each of these matters with certainty, they are of the belief that the resolution of these actions should not have a material adverse effect on our financial position, results of operations, or cash flows.

### **ITEM 1A. Risk Factors**

Please refer to our 2011 Form 10-K for disclosures with respect to our risk factors which could materially affect our business, financial condition, or future results. The risks described in the 2011 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also adversely affect our business, financial condition, or operating results. Except for the risks identified below, there have been no material changes from the risk factors previously disclosed in Part I, Item 1A, Risk Factors, of our 2011 Form 10-K.

*The Company may fail to realize the anticipated benefits of the Peoples and Waccamaw acquisitions.*

The success of the Peoples and Waccamaw acquisitions will depend on, among other things, the Company's ability to realize anticipated cost savings, to combine the businesses of Peoples and Waccamaw into the Company in a manner that does not materially disrupt the existing customer relationships of Peoples and Waccamaw or result in decreased revenues resulting from any loss of customers, and permit growth opportunities to occur. If the Company is not able to successfully achieve these objectives, the anticipated benefits of the acquisitions may not be realized fully, or at all, or may take longer to realize than expected.

*Reimbursements under loss share agreements are subject to compliance with certain requirements under the loss share agreements, FDIC oversight and interpretation, and contractual term limitations.*

The FDIC-assisted acquisition of Waccamaw completed in June of 2012 includes significant protection to the Company from the exposures to prospective losses on certain assets that are covered under loss share agreements with the FDIC. Loans covered under loss share agreements represent 13.21% of the Company's total loans held for investment as of June 30, 2012. Under these loss share agreements, the FDIC has agreed to cover 80% of most loan and foreclosed real estate losses. However, these loss share agreements impose certain obligations on the Company, including obligations to manage and service the loans in a prescribed manner and to report results and requests for reimbursement periodically. The obligations on the Company under the loss sharing agreements are extensive and failure to comply with any of the obligations could result in a specific asset or group of assets losing their loss sharing coverage. Requests for reimbursement are subject to FDIC review and may be delayed or disallowed for the Company's noncompliance with its obligations under the loss share agreements. In addition, the Company is subject to audits by the FDIC to ensure compliance with the loss share agreements.

The loss share agreements are subject to interpretation by both the FDIC and the Company, and disagreements may arise regarding coverage of losses, expenses, and contingencies. Additionally, losses that are currently projected to occur during the loss share term may not occur until after the expiration of the applicable loss share agreement and those losses could have a material impact on results of operations in future periods. The Company's current estimates of losses include only those losses that it projects to occur during the loss share period and for which the Company believes it will receive reimbursement from the FDIC at the applicable reimbursement rate.

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

(a) Not Applicable

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(b) Not Applicable

## (c) Issuer Purchases of Equity Securities

The following table provides information with respect to purchases made by or on behalf of our Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934) of our Company's Common Stock during the second quarter of 2012:

|                  | <b>Total Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>per<br/>Share</b> | <b>Total Number of<br/>Shares<br/>Purchased<br/>as Part of a Publicly<br/>Announced<br/>Plan</b> | <b>Maximum Number<br/>of Shares that<br/>May<br/>Yet be<br/>Purchased<br/>Under the Plan<br/>(1)</b> |
|------------------|-------------------------------------------------|-------------------------------------------------|--------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|
| April 1-30, 2012 |                                                 | \$                                              |                                                                                                  | 867,854                                                                                              |
| May 1-31, 2012   |                                                 |                                                 |                                                                                                  | 868,354                                                                                              |
| June 1-30, 2012  |                                                 |                                                 |                                                                                                  | 868,354                                                                                              |
| Total            |                                                 | \$                                              |                                                                                                  |                                                                                                      |

- (1) Our Company's stock repurchase plan, as amended, authorizes the purchase and retention of up to 1,100,000 shares. The plan has no expiration date and currently is in effect. No determination has been made to terminate the plan or to cease making purchases. We held 231,646 shares in treasury as of June 30, 2012.

**ITEM 3. Defaults Upon Senior Securities**

Not Applicable

**ITEM 4. Mine Safety Disclosures**

Not Applicable

**ITEM 5. Other Information**

None

**ITEM 6. Exhibits**

(a) Exhibits and index required

**Exhibit**

No.

Exhibit

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|          |                                                                                                                                                                   |
|----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3(i)     | Articles of Incorporation of First Community Bancshares, Inc., as amended (1)                                                                                     |
| 3(ii)    | Bylaws of First Community Bancshares, Inc., as amended and restated. (2)                                                                                          |
| 4.1      | Specimen stock certificate of First Community Bancshares, Inc. (3)                                                                                                |
| 4.2      | Indenture Agreement dated September 25, 2003. (4)                                                                                                                 |
| 4.3      | Declaration of Trust of FCBI Capital Trust dated September 25, 2003, as amended and restated. (5)                                                                 |
| 4.4      | Preferred Securities Guarantee Agreement dated September 25, 2003. (6)                                                                                            |
| 4.5      | Certificate of Designation of 6.00% Series A Noncumulative Convertible Preferred Stock. (7)                                                                       |
| 10.1**   | First Community Bancshares, Inc. 1999 Stock Option Agreement (8) and Plan. (9)                                                                                    |
| 10.1.1** | First Community Bancshares, Inc. 1999 Stock Option Plan, Amendment One. (10)                                                                                      |
| 10.2**   | First Community Bancshares, Inc. 2001 Nonqualified Director Stock Option Plan. (11)                                                                               |
| 10.3**   | Employment Agreement between First Community Bancshares, Inc. and John M. Mendez dated December 16, 2008, as amended and restated (21) and Waiver Agreement. (29) |
| 10.4**   | First Community Bancshares, Inc. and Affiliates Executive Retention Plan (12) and Amendment #1. (13)                                                              |
| 10.5**   | First Community Bancshares, Inc. Split Dollar Plan and Agreement. (14)                                                                                            |
| 10.6**   | First Community Bancshares, Inc. Supplemental Directors Retirement Plan, as amended and restated. (15)                                                            |
| 10.7**   | First Community Bancshares, Inc. Wrap Plan, as amended and restated. (16)                                                                                         |
| 10.8**   | Employment Agreement between First Community Bank and Marshall E. McCall dated March 1, 2012. (31)                                                                |
| 10.9**   | Form of Indemnification Agreement between First Community Bancshares, Inc., its Directors, and Certain Executive Officers. (17)                                   |

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|         |                                                                                                                                                                                |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.10** | Form of Indemnification Agreement between First Community Bank, its Directors, and Certain Executive Officers. (17)                                                            |
| 10.12** | First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan (18) and Stock Award Agreement. (19)                                                                           |
| 10.14** | First Community Bancshares, Inc. Directors Deferred Compensation Plan, as amended and restated. (20)                                                                           |
| 10.19** | Employment Agreement between First Community Bancshares, Inc. and David D. Brown dated December 16, 2008. (22)                                                                 |
| 10.20** | Employment Agreement between First Community Bancshares, Inc. and Robert L. Buzzo dated December 16, 2008, as amended and restated. (23)                                       |
| 10.21** | Employment Agreement between First Community Bancshares, Inc. and E. Stephen Lilly dated December 16, 2008, as amended and restated. (24)                                      |
| 10.22** | Employment Agreement between First Community Bank and Gary R. Mills dated December 16, 2008. (25)                                                                              |
| 10.23** | Employment Agreement between First Community Bank and Martyn A. Pell dated December 16, 2008. (26)                                                                             |
| 10.24** | Employment Agreement between First Community Bank and Robert L. Schumacher dated December 16, 2008. (27)                                                                       |
| 10.25** | Employment Agreement between First Community Bank and Simpson O. Brown dated July 31, 2009. (28)                                                                               |
| 10.26** | Employment Agreement between First Community Bank and Mark R. Evans dated July 31, 2009. (28)                                                                                  |
| 11      | Statement Regarding Computation of Earnings per Share. (30)                                                                                                                    |
| 31.1*   | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.                                                                                                             |
| 31.2*   | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.                                                                                                             |
| 32*     | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

\* Furnished herewith.

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

\*\*\* Submitted electronically herewith.

- (1) Incorporated by reference from Exhibit 3(i) of the Quarterly Report on Form 10-Q for the period ended June 30, 2010, filed on August 16, 2010.
- (2) Incorporated by reference from Exhibit 3.1 of the Current Report on Form 8-K dated May 27, 2008, filed on May 30, 2008.
- (3) Incorporated by reference from Exhibit 4.1 of the Annual Report on Form 10-K for the period ended December 31, 2002, filed on March 25, 2003, as amended on March 31, 2003.
- (4) Incorporated by reference from Exhibit 4.2 of the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.
- (5) Incorporated by reference from Exhibit 4.3 of the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.
- (6) Incorporated by reference from Exhibit 4.4 of the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.
- (7) Incorporated by reference from Exhibit 4.1 of the Current Report on Form 8-K dated May 20, 2011, filed on May 23, 2011.
- (8) Incorporated by reference from Exhibit 10.5 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
- (9) Incorporated by reference from Exhibit 10.1 of the Annual Report on Form 10-K for the period ended December 31, 1999, filed on March 30, 2000, as amended on April 13, 2000.
- (10) Incorporated by reference from Exhibit 10.1.1 of the Quarterly Report on Form 10-Q for the period ended March 31, 2004, filed on May 7, 2004.
- (11) Incorporated by reference from Exhibit 10.4 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
- (12) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated December 30, 2008, filed on January 5, 2009.
- (13) Incorporated by reference from Exhibit 10.3 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010.
- (14) Incorporated by reference from Exhibit 10.5 of the Annual Report on Form 10-K for the period ended December 31, 1999, filed on March 30, 2000, amended on April 13, 2000.
- (15) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010.
- (16) Incorporated by reference from Exhibit 99.1 of the Current Report on Form 8-K dated August 22, 2006, and filed on August 23, 2006.

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- (17) Form of indemnification agreement entered into by the Company and First Community Bank with their respective directors and certain officers of each including, for the Registrant and Bank: John M. Mendez, Robert L. Schumacher, Robert L. Buzzo, E. Stephen Lilly, David D. Brown, and Gary R. Mills. Incorporated by reference from the Annual Report on Form 10-K for the period ended December 31, 2003, filed on March 15, 2004, amended on May 19, 2004.

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- (18) Incorporated by reference from the 2004 First Community Bancshares, Inc. Definitive Proxy Statement filed on March 15, 2004.
- (19) Incorporated by reference from Exhibit 10.13 of the Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed on August 6, 2004.
- (20) Incorporated by reference from Exhibit 99.2 of the Current Report on Form 8-K dated August 22, 2006, and filed on August 23, 2006.
- (21) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated and filed December 16, 2008.
- (22) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated and filed December 16, 2008.
- (23) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated and filed July 6, 2009.
- (24) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated and filed July 6, 2009.
- (25) Incorporated by reference from Exhibit 10.3 of the Current Report on Form 8-K dated and filed July 6, 2009.
- (26) Incorporated by reference from Exhibit 10.4 of the Current Report on Form 8-K dated and filed July 6, 2009.
- (27) Incorporated by reference from Exhibit 10.5 of the Current Report on Form 8-K dated and filed July 6, 2009.
- (28) Incorporated by reference from Exhibit 2.1 of the Current Report on Form 8-K dated April 2, 2009, filed on April 3, 2009.
- (29) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010.
- (30) Incorporated by reference from Note 2 of the Notes to Condensed Consolidated Financial Statements included herein.
- (31) Incorporated by reference from Exhibit 2.1 of the Current Report on Form 8-K dated and filed on March 1, 2012.

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**SIGNATURES**

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

First Community Bancshares, Inc.

DATE: August 14, 2012

/s/ John M. Mendez  
John M. Mendez  
President & Chief Executive Officer  
(Principal Executive Officer)

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

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**EXHIBIT INDEX**

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