FIRST COMMUNITY BANCSHARES INC /NV/
Form 10-K
March 15, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

Commission file number 000-19297

FIRST COMMUNITY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

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

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

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

Title of each class	**Name of exchange on which registered**
Common Stock, $1.00 par value	NASDAQ Global Select

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

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer	¨	Accelerated filer	x
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 x No

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

Approximately $196.39 million based on the closing sales price at June 30, 2012.

Indicate the number of shares outstanding of each of the registrant s classes of Common Stock, as of the latest practicable date.

Class Common Stock, $1.00 Par Value; 20,047,484 shares outstanding as of February 27, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the annual meeting of shareholders to be held on April 30, 2013, are incorporated by reference in Part III of this Form 10-K.

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PART I

ITEM 1. Business.

Corporate Overview

First Community Bancshares, Inc. (the Company) is a financial holding company incorporated in 1997 under the laws of the State of Nevada and founded in 1989. The Company serves as the holding company for First Community Bank (the Bank), which is a Virginia-chartered banking institution founded in 1874. The Company also owns Greenpoint Insurance Group, Inc. (Greenpoint), a full-service insurance agency. The Bank is the parent of First Community Wealth Management, a registered investment advisory firm that offers wealth management and investment advice. The Company is the Common Stockholder of FCBI Capital Trust, which was created in October 2003 to issue trust preferred securities to raise capital for the Company.

The Company s banking operations are expected to remain the principal business and major source of revenue for the Company. The Company also considers and evaluates options for growth and expansion of the existing subsidiary banking operations. During 2012, the Company completed the acquisitions of Peoples Bank of Virginia (Peoples) and Waccamaw Bank (Waccamaw). Additional information regarding recent acquisitions can be found in Note 2 Business Combinations and Branching Activity of the Notes to Consolidated Financial Statements in Item 8 herein. Although the Company is a corporate entity, legally separate and distinct from its affiliates, bank holding companies, such as the Company, are required to act as a source of financial strength for their subsidiary banks. The principal source of the Company s income is dividends from the Bank. Dividend payments by the Bank are determined in relation to earnings, asset growth, and capital position and are subject to certain restrictions by regulatory agencies as described more fully under Regulation and Supervision The Bank of this item.

The Company s principal executive offices are located at One Community Place, Bluefield, Virginia 24605 and its telephone number is (276) 326-9000.

Business Overview

Through its subsidiaries, the Company offers commercial and consumer banking services and products, as well as wealth management and insurance services. Those products and services include the following:

- demand deposit accounts, savings and money market accounts, certificates of deposit, and individual retirement arrangements,
- commercial, consumer, real estate mortgage loans, and lines of credit,
- various debit card and automated teller machine card services,
- corporate and personal trust services,
- investment management services, and
- life, health, and property and casualty insurance products.

The Company provides financial services and conducts banking operations within the states of Virginia, West Virginia, North Carolina, South Carolina, and Tennessee. The Company serves a diverse customer base consisting of individual consumers and a wide variety of industries, including, among others, manufacturing, mining, services, construction, retail, healthcare, military and transportation. The Company is not dependent upon any single industry or customer. The Company had total consolidated assets of $2.73 billion at December 31, 2012, and conducts its banking operations through 72 locations.

Operating Segment

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,

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and insurance services. Prior to March 31, 2012, insurance services were reported as a separate operating segment. During the first quarter of 2012, management determined, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 280-10-50, that the Insurance Services segment no longer met the quantitative requirements for disclosure due to the sale of certain agencies during the third quarter of 2011. The operations of the Insurance Services segment were reasonably similar to the Community Banking segment; therefore, the two segments have been aggregated for disclosure purposes in the consolidated financial statements. Prior periods have been restated to reflect the Company s one operating segment, Community Banking. The Company s consolidated operating revenues, consolidated income or loss from operations, and total assets are hereby incorporated by reference from Item 6 of this Annual Report on Form 10-K.

Competition

There is significant competition among banks in the Company s market areas. The Company also competes with other providers of financial services, such as thrifts, savings and loan associations, credit unions, consumer finance companies, securities firms, insurance companies, insurance agencies, commercial finance and leasing companies, full service brokerage firms, and discount brokerage firms. The Company faces substantial competition for deposits and loans throughout its market areas. The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations, automated services and office hours. Competition for deposits comes primarily from other commercial banks, savings institutions, credit unions, mutual funds and other investment alternatives. The primary factors in competing for commercial and business loans are interest rates, loan origination fees, the quality and range of lending services and personalized service. Competition for origination of mortgage loans comes primarily from savings institutions, mortgage banking firms, mortgage brokers, other commercial banks and insurance companies. Factors which affect competition include the general and local economic conditions, current interest rate levels and volatility in the mortgage markets. Some of the Company s competitors have greater resources and, as such, may have higher lending limits and may offer other services that are not provided by the Company. Competition could intensify in the future as a result of industry consolidation, the increasing availability of products and services from non-banks, greater technological developments in the industry, and banking regulatory reform. See Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview Competition in Item 7 herein.

Employees

The Company and its subsidiaries employed 760 full-time equivalent employees at December 31, 2012. Management considers employee relations to be excellent.

Regulation and Supervision

General

The supervision and regulation of the Company and its subsidiaries by applicable federal and state banking agencies is intended primarily for the protection of depositors, the Deposit Insurance Fund (DIF) of the Federal Deposit Insurance Corporation (FDIC), and the banking system as a whole, and not for the protection of stockholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks, including the power to impose substantial fines and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and the Bank are subject. References in the following description to applicable statutes and regulations are brief summaries of these statutes and regulations, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations. A change in statutes, regulations or regulatory policies applicable to the Company and its subsidiaries could have a material effect on the business of the Company.

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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.

- 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 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.

The Company

The Company is a financial holding company pursuant to the Gramm-Leach-Bliley Act (the GLB Act) and a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the BHCA). Accordingly, the Company is subject to supervision, regulation and examination by the Federal Reserve Board. The BHCA, the GLB Act, and other federal laws subject financial and bank holding companies to particular restrictions on the types of activities in which they may engage and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. The BHCA generally provides for umbrella regulation of financial holding companies, such as the Company, by the Federal Reserve Board, and for functional regulation of banking activities by bank regulators, securities activities by securities regulators, and insurance activities by insurance regulators.

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

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide such resources. As discussed below, a bank holding company in certain circumstances could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

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

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

Under the GLB Act, a bank holding company may become a financial holding company by filing a declaration with the Federal Reserve Board if each of its subsidiary banks is well capitalized under the Federal Deposit Insurance Corporation Improvement Act of 1991 prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act of 1977. The Company elected financial holding company status in December 2006. Beginning in July 2011, the Company s financial holding company status also depends upon it maintaining its status as well capitalized and well managed under applicable Federal Reserve Board regulations. If a financial holding company ceases to meet these requirements, the Federal Reserve Board may impose corrective capital and/or managerial requirements on the financial holding company and place limitations on its ability to conduct the broader financial activities permissible for financial holding companies. In addition, the Federal Reserve Board may require divestiture of the holding company s depository institutions if the deficiencies persist.

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

Stock Repurchases. A bank holding company is required to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company s consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation.

Capital Adequacy Requirements. The Federal Reserve Board has promulgated capital adequacy guidelines for use in its examination and supervision of bank holding companies. If a bank holding company s capital falls below minimum required levels, then the bank holding company must implement a plan to increase its capital, and its ability to pay dividends, make acquisitions of new bank subsidiaries, or engage in certain other activities may be restricted or prohibited.

The Federal Reserve Board currently uses two types of capital adequacy guidelines for holding companies, a two-tiered risk-based capital guideline and a leverage capital ratio guideline. The two-tiered risk-based capital guideline assigns risk weightings to all assets and certain off-balance sheet items of the holding company s operations, and then establishes a minimum ratio of the holding company s Tier 1 capital to the aggregate dollar amount of risk-weighted assets (which amount is usually less than the aggregate dollar amount of such assets without risk weighting) and a minimum ratio of the holding company s total capital (Tier 1 capital plus Tier 2 capital, as adjusted) to the aggregate dollar amount of such risk-weighted assets. The leverage ratio guideline establishes a minimum ratio of the holding company s Tier 1 capital to its total tangible assets (total assets less goodwill and certain identifiable intangibles), without risk-weighting. As discussed below, the Bank is subject to similar capital requirements.

Under both guidelines, Tier 1 capital is defined to include: common shareholders equity (including retained earnings), qualifying noncumulative perpetual preferred stock and related surplus, qualifying cumulative perpetual preferred stock and related surplus, minority interests in the equity accounts of consolidated subsidiaries (limited to a maximum of 25% of Tier 1 capital), and certain trust preferred securities. The Dodd-Frank Act excludes trust preferred securities issued after May 19, 2010, from being included in Tier 1 capital, unless the issuing company is a bank holding company with less than $500 million in total assets. Trust preferred securities issued prior to that date will continue to count as Tier 1 capital for bank holding companies with less than $15 billion in total assets, such as the Company. Goodwill and most intangible assets are deducted from Tier 1 capital. For purposes of the total risk-based capital guidelines, Tier 2 capital (sometimes referred to as supplementary capital) is defined to include, subject to limitations: perpetual preferred stock not included in Tier 1 capital, intermediate-term preferred stock and any related surplus, certain hybrid capital instruments, perpetual debt and mandatory convertible debt securities, allowances for loan and lease losses, and intermediate-term subordinated debt instruments. The maximum amount of qualifying Tier 2 capital is 100% of qualifying Tier 1 capital. For purposes of the total capital guideline, total capital equals Tier 1 capital, plus qualifying Tier 2 capital, minus investments in unconsolidated subsidiaries, reciprocal holdings of bank holding company capital securities, and deferred tax assets and other deductions. The Federal Reserve Board s current capital adequacy guidelines require that a bank holding company maintain a Tier 1 risk-based capital ratio of at least 4.0% and a total risk-based capital ratio of at least 8.0%. At December 31, 2012, the Company s ratio of Tier 1 capital to total risk-weighted assets was 15.44% and its ratio of total capital to risk-weighted assets was 16.70%.

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company s Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of 4.0% or more, depending on their overall condition. At December 31, 2012, the Company s leverage ratio was 9.96%.

The federal banking agencies risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal

Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

The current risk-based capital guidelines that apply to the Company and the Bank are based on the 1988 capital accord of the International Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, as implemented by the Federal Reserve Board. On June 7, 2012, the federal bank regulatory agencies issued a series of proposed rules that would revise their risk-based and leverage capital requirements and their method for calculating risk-weighted assets to make them consistent with the agreements that were reached by the Basel Committee on Banking Supervision in Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (Basel III) and certain provisions of the Dodd-Frank Act. The proposed rules would apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more, and top-tier savings and loan holding companies (banking organizations). Among other things, the proposed rules establish a new common equity Tier 1 minimum capital requirement of 4.5% and a higher minimum Tier 1 capital requirement of 6.0% and assign higher risk weightings (150%) to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. Additionally, the U.S. implementation of Basel III contemplates that, for banking organizations with less than $15 billion in assets, the ability to treat trust preferred securities as Tier 1 capital would be phased out over a ten-year period. The proposed rules also required unrealized gains and losses on certain securities holdings to be included for purposes of calculating regulatory capital requirements. The proposed rules limit a banking organization s capital distributions and certain discretionary bonus payments if the banking organization does not hold a capital conservation buffer consisting of a specified amount of common equity Tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. The proposed rules indicated that the final rule would become effective on January 1, 2013, and the changes set forth in the final rules will be phased in from January 1, 2013 through January 1, 2019. However, the agencies have recently indicated that, due to the volume of public comments received, the final rule would not be in effect on January 1, 2013.

When fully phased in on January 1, 2019, Basel III requires banks to maintain the following new standards and introduces a new capital measure Common Equity Tier 1, or CET1 . Basel III increases the CET1 to risk-weighted assets to 4.5%, and introduces a capital conservation buffer of an additional 2.5% of common equity to risk-weighted assets, raising the target CET1 to risk-weighted assets ratio to 7%. It requires banks to maintain a minimum ratio of Tier 1 capital to risk weighted assets of at least 6.0%, plus the capital conservation buffer effectively resulting in a Tier 1 capital ratio of 8.5%. Basel III increases the minimum total capital ratio to 8.0% plus the capital conservation buffer, increasing the minimum total capital ratio to 10.5%. Basel III also introduces a non-risk adjusted Tier 1 leverage ratio of 3%, based on a measure of total exposure rather than total assets, and new liquidity standards.

Failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for a financial institution could subject the Bank or the Company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting or renewing brokered deposits, limitations on the rates of interest that the institution may pay on its deposits and other restrictions on its business. As described above, significant additional restrictions can be imposed on the Bank if it would fail to meet applicable capital requirements.

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

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Incentive Compensation. In June 2010, the Federal Reserve Board, the OCC and the FDIC issued their final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk taking. The final guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, is based upon the key principles that a banking organization s incentive compensation arrangements should (i) provide incentives that do not encourage risk taking beyond the organization s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization s board of directors. The Federal Reserve Board indicated that all banking organizations are to evaluate their incentive compensation arrangements and related risk management, controls, and corporate governance processes and immediately address deficiencies in these arrangements or processes that are inconsistent with safety and soundness.

The Federal Reserve Board will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not large, complex banking organizations. These reviews will be tailored to each organization based on the scope and complexity of the organization s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization s supervisory ratings, which can affect the organization s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In February 2011, the Federal Reserve Board, the OCC and the FDIC approved a joint proposed rulemaking to implement Section 956 of the Dodd-Frank Act, which prohibits incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions and are deemed to be excessive, or that may lead to material losses.

The scope and content of the U.S. banking regulators policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the Company s ability to hire, retain and motivate its key employees.

The Bank

The Bank is a Virginia state-chartered bank supervised and regulated by the Virginia Bureau of Financial Institutions (the Virginia Bureau) and as a member of the Federal Reserve, the Bank s primary federal regulator is the Federal Reserve Bank of Richmond (FRB), both of which are based in the Company s home state of Virginia. The regulations of these agencies govern most aspects of the Bank s business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends and location and number of branch offices.

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

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

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The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates under Sections 23A and 23B of the Federal Reserve Act, including an expansion of the definition of covered transactions and an increase in the amount of time for which collateral requirements regarding covered credit transactions must be satisfied. Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivatives transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution s board of directors.

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

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

Capital adequacy requirements applicable to insured depository institutions serve to limit the amount of dividends that may be paid by the Bank. Under federal law, the Bank cannot pay a dividend if, after paying the dividend, it will be classified as undercapitalized. Further, prior approval of the Federal Reserve Board is required if cash dividends declared in any given year exceed the total of the Bank s net profits for such year, plus its retained profits for the preceding two years. Virginia law also imposes restrictions on the ability of Virginia-chartered banks to pay dividends if such dividends would impair a bank s paid-in capital. The payment of dividends by the Bank may also be limited by other factors, such as requirements to maintain capital above regulatory guidelines. The Virginia Bureau and the Federal Reserve Board have the general authority to limit dividends paid by the Bank if such payments are deemed to constitute an unsafe and unsound practice.

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

Examinations. Under the Federal Deposit Insurance Corporation Improvement Act, all insured institutions must undergo regular on-site examination by their appropriate banking agency and such agency may assess the institution for its costs of conducting the examination. As a state-chartered, Federal Reserve member bank, the Bank is subject to examination by the Virginia Bureau and FRB. These examinations review areas such as capital adequacy, reserves, loan portfolio quality and management, consumer and other compliance issues, investments, information systems, disaster recovery, and contingency planning and management practices.

Capital Adequacy Requirements. The various federal bank regulatory agencies, including the Federal Reserve Board, have adopted risk-based capital requirements for assessing the capital adequacy of banks and bank holding companies. The federal capital standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, as adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profile among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

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Pursuant to the Federal Reserve Board s risk-based capital requirements, state member banks are required to meet a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for the Bank as for the Company. See Regulation and Supervision The Company Capital Adequacy Requirements for additional information on the capital requirements applicable to the Bank.

In addition to the risk-based capital requirements, the Federal Reserve Board has adopted regulations that supplement the risk-based guidelines to include a minimum leverage ratio of Tier 1 capital to quarterly average assets of 3.0%. The Federal Reserve Board has emphasized that the foregoing standards are supervisory minimums and that a banking organization will be permitted to maintain such minimum levels of capital only if it receives the highest rating under the regulatory rating system and the banking organization is not experiencing or anticipating significant growth. All other banking organizations are required to maintain a leverage ratio of at least 4.0% to 5.0% of Tier 1 capital. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A well capitalized institution has a to risk-based capital ratio of 10.0% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An adequately capitalized institution has a total risk-based capital ratio of 8.0% or higher; a Tier 1 risk-based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well capitalized bank. An undercapitalized institution has a total risk-based capital ratio that is less than 8.0%; a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 4.0%. A significantly undercapitalized institution has a total risk-based capital ratio of less than 6.0%; a Tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%. A critically undercapitalized institution s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank s overall financial condition or prospects for other purposes. The Bank was classified as well capitalized for purposes of the FDIC s prompt corrective action regulation as of December 31, 2012.

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

As an institution s capital decreases, the federal regulators enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The FDIC has limited discretion in dealing with a critically undercapitalized institution and is generally required to appoint a receiver or conservator. Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Deposit Insurance Assessments. The Bank s deposits are insured up to applicable limits by the DIF of the FDIC and are subject to deposit insurance assessments to maintain the DIF. Currently the FDIC utilizes a risk-based assessment system to evaluate the risk of each financial institution based on three primary sources of information: (1) its supervisory rating, (2) its financial ratios, and (3) its long-term debt issuer rating, if the institution has one. The FDIC s initial base assessment schedule can be adjusted up or down, and premiums in effect from January 1, 2010, through March 31, 2011, ranged from 12 basis points in the lowest risk category to 45 basis points for banks in the highest risk category. Effective April 1, 2011, the FDIC set initial base assessment rates from 5 basis points in the lowest risk category to 35 basis points for banks in the higher risk category.

The Dodd-Frank Act requires the FDIC to increase the DIF s reserves against future losses, which will necessitate increased deposit insurance premiums that are to be borne primarily by institutions with assets of greater than $10 billion. In October 2010, the FDIC addressed plans to bolster the DIF by increasing the required reserve ratio for the industry to 1.35 percent (ratio of reserves to insured deposits) by September 30, 2020, as required by the Dodd-Frank Act. The FDIC also proposed to raise its industry target ratio of reserves to insured deposits to 2 percent, 65 basis points above the statutory minimum.

In February 2011, the FDIC adopted new rules that amend its current deposit insurance assessment regulations. The new rules implement a provision in the Dodd-Frank Act that changed the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average tangible equity. The rules also changed the assessment rate schedules for insured depository institutions so that approximately the same amount of revenue would be collected under the new assessment base as would be collected under the current rate schedule and the schedules previously proposed by the FDIC in October 2010. In addition, the new rules revised the risk-based assessment system for large insured depository institutions (generally, institutions with at least $10 billion in total assets) and highly complex institutions by requiring that the FDIC use a scorecard method to calculate assessment rates for all such institutions. The Bank will not be deemed a highly complex institution for these purposes.

Under the Federal Deposit Insurance Act, as amended (the FDIA), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

In addition to deposit insurance assessments by the DIF, all FDIC-insured depository institutions must pay an annual assessment to provide funds for the repayment of debt obligations of the Financing Corporation (FICO). The FICO is a government-sponsored entity that was formed to borrow the money necessary to carry out the closing and ultimate disposition of failed thrift institutions by the Resolution Trust Corporation. The FICO assessments are set quarterly. The Bank paid FICO assessments of $140 thousand for the year ended December 31, 2012, and $154 thousand for the year ended December 31, 2011. The Bank paid approximately $1.57 million during 2012 for FDIC deposit insurance premiums.

Safety and Soundness Standards. The FDIA requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal stockholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice

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by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the prompt corrective action provisions of the FDIA. See Regulation and Supervision The Bank Corrective Measures for Capital Deficiencies for additional information. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

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

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

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

The Dodd-Frank Act provided for the creation of the CFPB as an independent entity within the Federal Reserve Board. The CFPB has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards. The CFPB s functions include investigating consumer complaints, rulemaking, supervising and examining banks consumer transactions, and enforcing rules related to consumer financial products and services. Banks with less than $10 billion in assets, such as the Bank, will continue to be examined for compliance with federal consumer financial laws by their primary federal banking agency.

USA PATRIOT Act of 2001. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Patriot Act) was enacted in October 2001. The Patriot Act has broadened existing anti-money laundering legislation while imposing new compliance and due diligence obligations on banks and other financial institutions, with a particular focus on detecting and reporting money laundering transactions involving domestic or international customers. The U.S. Treasury Department has issued and will continue to issue regulations clarifying the Patriot Act s requirements. The Patriot Act requires all financial institutions, as defined, to establish certain anti-money laundering compliance and due diligence programs. Recently, the regulatory agencies have intensified their examination procedures in light of the Patriot Act s anti-money laundering and Bank Secrecy Act requirements. The Company believes that its controls and procedures were in compliance with the Patriot Act as of December 31, 2012.

Interstate Banking and Branching. The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether the transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle-Neal Act) or by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997, that applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Such interstate bank mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act.

Prior to the enactment of the Dodd-Frank Act, national and state-chartered banks were generally permitted to branch across state lines by merging with banks in other states if allowed by the applicable states laws. However, interstate branching is now permitted for all national and state-chartered banks as a result of the Dodd-Frank Act, provided that a state bank chartered by the state in which the branch is to be located would also be permitted to establish a branch, thus effectively giving out-of-state banks parity with in-state banks with respect to de novo branching.

Repurchase of Securities Issued in the Troubled Asset Relief Program Capital Purchase Program

On November 21, 2008, the Company issued and sold to the U.S. Department of the Treasury (Treasury) (i) 41,500 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Shares) and (ii) a Warrant (the Warrant) to purchase 176,546 shares of the Company s Common Stock, par value $1.00 per share (the Common Stock), for an aggregate purchase price of $41.50 million in cash. On June 5, 2009, the Company completed a public offering of its Common Stock that resulted in the reduction of the shares of Common Stock underlying the Warrant from 176,546 shares to 88,273 shares. On July 8, 2009, the Company repurchased from the Treasury all of the Preferred Shares that it had issued to the Treasury in November 2008. On November 23, 2011, the Company repurchased the Warrant from the Treasury for $30,600. The purchase price represents the amount that the Company bid in a public auction for the Warrant that took place on November 17, 2011. The Warrant had a 10-year term and was immediately exercisable upon its issuance, with an initial per share exercise price of $35.26.

Series A Noncumulative Convertible Preferred Stock

On May 20, 2011, the Company completed a private placement of 18,921 shares of its 6.00% Series A Noncumulative Convertible Preferred Stock (the Series A Preferred Stock). The shares carry a 6.00% dividend rate and are noncumulative. Each share is convertible into 69 shares of the Company s Common Stock at any time and mandatorily converts after five years. The Company may redeem the shares at face value after the third anniversary. As of December 31, 2012, 17,421 shares of Series A Preferred Stock were outstanding.

Available Information

Under the Securities Exchange Act of 1934, as amended (the Exchange Act), the Company is required to file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). Any document the Company files with the SEC may be read and copied at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at (800) SEC-0330 for further information about the public reference room. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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

Also posted on the Company s website, and available in print upon written request of any shareholder to the Company s Investor Relations Department, are the charters of the standing committees of its Board of Directors, the Standards of Conduct governing the Company s directors, officers, and employees, and the Company s Insider Trading & Disclosure Policy.

Forward-Looking Statements

We may make forward-looking statements in filings with the Securities and Exchange Commission (the SEC) including this Annual Report on Form 10-K 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 expression 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, which 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.

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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 Annual Report on Form 10-K 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 Item 1A, Risk Factors,

ITEM 1A. Risk Factors.

An investment in the Company s Common Stock is subject to risks inherent to the Company s business. The material risks and uncertainties that management believes affect the Company are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company s business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the Company s financial condition and results of operations could be materially and adversely affected. If this were to happen, the market price of the Company s Common Stock could decline significantly, and you could lose all or part of your investment.

Risks Related to the Company s Business

The current economic environment poses significant challenges for the Company and could adversely affect its financial condition and results of operations.

The U.S. economy was in recession from December 2007 through June 2009. Business activity across a wide range of industries and regions in the U. S. was greatly reduced. Although economic conditions have improved, certain sectors, such as real estate and manufacturing, remain weak and unemployment remains high. Continued declines in real estate values, home sales volumes, and financial stress on borrowers as a result of the uncertain economic environment could have an adverse effect on the Company s borrowers or its customers, which could adversely affect the Company s financial condition and results of operations. In addition, local governments and many businesses are still experiencing difficulty due to lower consumer spending and decreased liquidity in the credit markets. Deterioration in local economic conditions, particularly within the Company s geographic regions and markets, could drive losses beyond that which is provided for in its allowance for loan losses. The Company may also face the following risks in connection with these events:

- Economic conditions that negatively affect housing prices and the job market have resulted, and may continue to result, in deterioration in credit quality of the Company s loan portfolios, and such deterioration in credit quality has had, and could continue to have, a negative impact on the Company s business.

- Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities.

- The processes the Company uses to estimate allowance for loan losses and reserves may no longer be reliable because they rely on complex judgments that may no longer be capable of accurate estimation.

- The Company s ability to assess the creditworthiness of its customers may be impaired if the models and approaches it uses to select, manage, and underwrite its customers become less predictive of future charge-offs.

The Company expects to face increased regulation of its industry, and compliance with such regulation may increase its costs, limit its ability to pursue business opportunities, and increase compliance challenges.

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As the above conditions or similar ones continue to exist or worsen, the Company could experience continuing or increased adverse effects on its financial condition and results of operations.

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

The Company s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company s control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company s ability to originate loans and obtain deposits, and (ii) the fair value of the Company s financial assets and liabilities. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

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

Like all financial institutions, the Bank maintains an allowance for loan losses to provide for probable losses. The Bank s allowance for loan losses may not be adequate to cover actual loan losses and future provisions for loan losses could materially and adversely affect the Bank s operating results. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires the Bank to make significant estimates of current credit risks and future trends, all of which may undergo material changes. The Bank s allowance for loan losses is determined by analyzing historical loan losses, current trends in delinquencies and charge-offs, plans for problem loan resolution, changes in the size and composition of the loan portfolio, and industry information. Also included in management s estimates for loan losses are considerations with respect to the impact of economic events, the outcome of which are uncertain. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond the Bank s control, and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review the Bank s loans and allowance for loan losses. Although the Company believes that the Bank s allowance for loan losses is adequate to provide for probable losses, there are no assurances that future increases in the allowance for loan losses will not be needed or that regulators will not require the Bank to increase its allowance. Either of these occurrences could materially and adversely affect the Company s earnings and profitability.

The Company has experienced increases in the levels of nonperforming assets in recent periods. The Company s total non-covered, nonperforming assets totaled $35.69 million at December 31, 2012, $31.0 million at December 31, 2011, and $29.65 million at December 31, 2010. The Company had $6.11 million of net loan charge-offs for the year ended December 31, 2012, compared to $9.32 million and $12.55 million in net loan charge-offs for the years ended December 31, 2011 and 2010, respectively. The Company s provision for loan losses was $5.68 million for the year ended December 31, 2012, $9.05 million for the year ended December 31, 2011, and $14.76 million for the year ended December 31, 2010. At December 31, 2012, the Company had no allowance for loan losses for covered loans. At December 31, 2012, the ratios of the Company s allowance for loan losses to non-covered, nonperforming loans and to total non-covered loans outstanding were 86.07% and 1.71%, respectively. Additional increases in the Company s nonperforming assets or loan charge-offs may require an increase to the allowance for loan losses, which would have an adverse effect upon the Company s future results of operations.

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The current economic environment poses uncertainties related to the real estate market and could adversely impact the Company s business.

The Company s business activities are conducted in Virginia, West Virginia, North Carolina, South Carolina, Tennessee and the surrounding regions. While the real estate market is beginning to improve slightly, there has been slowdown over the past several years resulting in falling home prices and increased foreclosures. A continued downturn in this regional real estate market could hurt the Company s business because its operations are concentrated within this geographic area and the vast majority of the Company s loans are secured by real estate. If there is a further decline in real estate values, the collateral for the Company s loans will provide less security. As a result, the Company s ability to recover on defaulted loans by selling the underlying real estate will be diminished, and it will be more likely to suffer losses on defaulted loans.

Additionally, further weakness in the secondary market for residential lending could have a material adverse impact on the Company s profitability. Slowdown in the secondary market for residential mortgage loans limits the market for and liquidity of most mortgage loans other than conforming Fannie Mae and Freddie Mac loans. The effects of ongoing mortgage market challenges, combined with ongoing correction in residential real estate market prices and reduced levels of home sales, could adversely affect the value of collateral securing mortgage loans, mortgage loan originations, and gains on sale of mortgage loans. Continued declines in real estate values and home sales volumes, and financial stress on borrowers as a result of job losses or other factors, could have further adverse effects on borrowers that result in higher delinquencies and greater charge-offs in future periods, which could materially and adversely affect the Company.

The Company s level of credit risk may increase due to its focus on commercial lending and the concentration on small businesses and middle market customers with significant vulnerability to economic conditions.

Commercial business and commercial real estate loans generally are considered riskier than single family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial business and commercial real estate loans involve risks because the borrowers ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Company s commercial business loans are made to small business or middle market customers who may have a significant vulnerability to economic conditions. Moreover, a portion of these loans have been made or acquired by the Company in recent years and the borrowers may not have experienced a complete business or economic cycle. At December 31, 2012, the Company s largest outstanding commercial business loan and largest outstanding commercial real estate loan amounted to $6.50 million and $7.11 million, respectively. At such date, the Company s commercial business loans amounted to $95.69 million, or 5.55% of the Company s total loan portfolio, and the Company s commercial real estate loans amounted to $750.53 million, or 43.52% of the Company s total loan portfolio.

In addition to commercial real estate and commercial business loans, the Company holds a portfolio of commercial construction loans. Construction loans generally have a higher risk of loss primarily due to the critical nature of the initial estimates of a property s value upon completion of construction compared with the estimated costs, including interest, of construction as well as other assumptions. If the estimates upon which construction loans are made prove to be inaccurate, the Company may be confronted with projects that, upon completion, have values which are below the loan amounts. While the Company is not aware of any specific, material impediments impacting any of its builder/developer borrowers at this time, there continues to be nationwide reports of significant problems which have adversely affected many property developers and builders as well as the institutions that have provided those loans. If significant numbers of the builder/developers to which the Company has extended construction loans experience the type of difficulties that are being reported, it could have adverse consequences upon future results of operations. At December 31, 2012, the Company s largest outstanding commercial construction loan amounted to $4.94 million. At such date, the Company s commercial construction loans amounted to $84.03 million, or 4.70% of the Company s total loan portfolio.

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

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

Changes in the fair value of the Company s securities may reduce its stockholders equity and net income.

At December 31, 2012, $534.36 million of the Company s securities were classified as available-for-sale. At such date, the aggregate unrealized losses on the Company s available-for-sale securities totaled $14.86 million. The Company increases or decreases stockholders equity by the amount of the change in the unrealized gain or loss (the difference between the estimated fair value and the amortized cost) of the Company s available-for-sale securities portfolio, net of the related tax effect, under the category of accumulated other comprehensive loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered at the maturity of the securities. In the case of equity securities which have no stated maturity, the declines in fair value may or may not be recovered over time.

The Company conducts periodic reviews and evaluations of its entire securities portfolio to determine if the decline in the fair value of any security below its cost basis is other-than-temporary. Factors which the Company considered in its analysis of debt securities include, but are not limited to, intent to sell the securities, evidence available to determine if it is more likely than not that the Company will have to sell the securities before recovery of the amortized cost, and probable credit losses. Probable credit losses are evaluated based upon, but are not limited to: the present value of future cash flows, the severity and duration of the decline in fair value of the security below its amortized cost, the financial condition and near-term prospects of the issuer, whether the decline appears to be related to issuer conditions or general market or industry conditions, the payment structure of the security, failure of the security to make scheduled interest or principal payments, and changes to the rating of the security by rating agencies. The Company generally views changes in fair value for debt securities caused by changes in interest rates as temporary, which is consistent with the Company s experience. If the Company deems such decline to be other-than-temporary, the security is written down to a new cost basis and the resulting loss is charged to earnings as a component of noninterest income. For the year ended December 31, 2012, the Company recognized other-than-temporary impairment (OTTI) charges of $942 thousand on its debt securities portfolio.

Factors that the Company considers in its analysis of equity securities include, but are not limited to: intent to sell the security before recovery of the cost, the severity and duration of the decline in fair value of the security below its cost, the financial condition and near-term prospects of the issuer, and whether the decline appears to be related to issuer conditions or general market or industry conditions. For the year ended December 31, 2012, the Company recognized no OTTI charges on its equity securities portfolio.

The Company continues to monitor the fair value of its entire securities portfolio as part of its ongoing OTTI evaluation process. No assurance can be given that the Company will not need to recognize OTTI charges related to securities in the future.

The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 may have a material effect on the Company s operations.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, which imposes significant regulatory and compliance changes. The key provisions of the Dodd-Frank Act that are anticipated to affect the Company s operations include:

- changes to regulatory capital requirements;
- creation of new government regulatory agencies, including the Consumer Financial Protection Bureau;
- limitation on federal preemption;
- changes in insured depository institution regulations and assessments; and
- mortgage loan origination and risk retention.

Many of the requirements of the Dodd-Frank Act will be implemented over time and most will be subject to the rulemaking process at various regulatory agencies. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on the Company s operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require the Company to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements or with any future changes in laws or regulations may negatively impact our results of operations and financial condition.

The short-term and long-term impact of the changing regulatory capital requirements and anticipated new capital rules is uncertain.

On June 7, 2012, the Federal Reserve, FDIC and OCC approved proposed rules that would substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The proposed rules implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The proposed rules were subject to a public comment period that has expired and there is no date set for the adoption of final rules.

Various provisions of the Dodd-Frank Act increase the capital requirements of bank holding companies, such as the Company. The leverage and risk-based capital ratios of these entities may not be lower than the leverage and risk-based capital ratios for insured depository institutions. The proposed rules include new minimum risk-based capital and leverage ratios, which would be phased in during 2013 and 2014, and would refine the definition of what constitutes capital for purposes of calculating those ratios. The proposed new minimum capital level requirements applicable to the Company and the Bank under the proposals would be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The proposed rules would also establish a capital conservation buffer of 2.5% above the new regulatory minimum capital ratios, and would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement would be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase each year until fully implemented in January 2019. Moreover, the proposed reforms seek to eliminate trust preferred securities from Tier 1 capital over a ten-year period. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations would establish a maximum percentage of eligible retained income that could be utilized for such actions. Additionally, the U.S. implementation of Basel III contemplates that, for banking organizations with less than $15 billion in assets, the ability to treat trust preferred securities as Tier 1 capital would be phased out over a ten-year period.

While the proposed Basel III changes and other regulatory capital requirements will likely result in generally higher regulatory capital standards, it is difficult at this time to predict when or how any new standards will ultimately be applied to the Company and the Bank.

In addition, in the current economic and regulatory environment, regulators of banks and bank holding companies have become more likely to impose capital requirements on bank holding companies and banks that are more stringent than those required by applicable existing regulations.

The application of more stringent capital requirements for the Company and the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in additional regulatory actions if the Company and the Bank were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying dividends.

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

The Company and its subsidiaries operations are subject to extensive regulation and supervision by federal and state governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of the Company s operations. Banking regulations governing the Company s operations are primarily intended to protect depositors funds, federal deposit insurance funds and the banking system as a whole, not stockholders. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company s business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. These laws, rules and regulations, or any other laws, rules or regulations that may be adopted in the future, could make compliance more difficult or expensive, restrict the Company s ability to originate, broker or sell loans, further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by the Bank and otherwise adversely affect the Company s business, financial condition or prospects.

The financial services industry is likely to face increased regulation and supervision as a result of the recent financial crisis. Such additional regulation and supervision may increase the Company s costs and limit its ability to pursue business opportunities. The affects of such recently enacted, and proposed, legislation and regulatory programs on the Company cannot reliably be determined at this time.

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

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

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Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Bank and other factors, that the Federal Reserve Board or the Virginia Bureau, the Bank s primary regulators, could assert that payment of dividends or other payments by the Bank are an unsafe or unsound practice. In the event the Bank is unable to pay dividends sufficient to satisfy the Company s obligations or is otherwise unable to pay dividends to the Company, the Company may not be able to service its obligations as they become due, including payments required to be made to the FCBI Capital Trust, a business trust subsidiary of the Company, or pay dividends on the Company s Common Stock or Series A Preferred Stock. Consequently, the inability to receive dividends from the Bank could adversely affect the Company s financial condition, results of operations, cash flows and prospects.

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

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

Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger clients. These institutions, particularly to the extent they are more diversified than the Company, may be able to offer the same loan products and services that the Company offers at more competitive rates and prices. If the Company is unable to attract and retain banking clients, the Company may be unable to continue the Bank s loan and deposit growth and the Company s business, financial condition and prospects may be negatively affected.

Potential acquisitions may disrupt the Company s business and dilute stockholder value.

The Company may seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- Potential exposure to unknown or contingent liabilities of the target company.
- Exposure to potential asset quality issues of the target company.
- Difficulty, expense, and delays of integrating the operations and personnel of the target company.
- Potential disruption to the Company s business.
- Potential diversion of the Company s management s time and attention.
- The possible loss of key employees and customers of the target company.
- Difficulty in estimating the value of the target company.

Potential changes in banking or tax laws or regulations that may affect the target company.

Unexpected costs and delays.

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Risks that the acquired target company does not perform consistent with the Company s growth and profitability expectations.

Risks associated with entering new markets or product areas where the Company has limited experience.

Risks that growth will strain the Company s infrastructure, staff, internal controls and management, which may require additional personnel, time and expenditures.

Potential short-term decreases in profitability.

The Company regularly evaluates merger and acquisition opportunities and conducts due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving the payment of cash or the issuance of debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some initial dilution of the Company s tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on the Company s financial condition and results of operations.

The Company may fail to realize the anticipated benefits of the Peoples Bank of Virginia and Waccamaw Bank 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.

The Company may engage in FDIC-assisted transactions, which could present additional risks to its business.

The Company may have opportunities to acquire the assets and liabilities of failed banks in FDIC-assisted transactions, which present the risks of acquisitions discussed above, as well as some risks specific to these transactions. Because FDIC-assisted acquisitions provide for limited diligence and negotiation of terms, these transactions may require additional resources and time, including servicing acquired problem loans and costs related to integration of personnel and operating systems, and the establishment of processes to service acquired assets. Such transactions may also require the Company to raise additional capital, which may be dilutive to existing stockholders. If the Company is unable to manage these risks, FDIC-assisted acquisitions could have a material adverse effect on its business, financial condition and results of operations.

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 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 share 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 share 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.

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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.

Attractive acquisition opportunities may not be available in the future.

The Company expects that other banking and financial companies, many of which have significantly greater resources, will compete with it to acquire financial services businesses. This competition could increase prices for potential acquisitions that the Company believes are attractive. Also, acquisitions are subject to various regulatory approvals. If the Company fails to receive the appropriate regulatory approvals, it will not be able to consummate an acquisition that it believes is in its best interests. Among other things, the Company s regulators consider the Company s capital, liquidity, profitability, regulatory compliance and levels of goodwill and intangibles when considering acquisition and expansion proposals. Any acquisition could be dilutive to the Company s earnings and stockholders equity per share of the Company s Common Stock and Series A Preferred Stock.

The Company s goodwill may be determined to be impaired.

As of December 31, 2012, the carrying amount of the Company s goodwill was $104.87 million. The Company tests goodwill for impairment on an annual basis, or more frequently if necessary. Quoted market prices in active markets are the best evidence of fair value and are to be used as the basis for measuring impairment, when available. Other acceptable valuation methods include present-value measurements based on multiples of earnings or revenues, or similar performance measures. If the Company determines that the carrying amount of its goodwill exceeds its implied fair value, the Company would be required to write down the value of the goodwill on its balance sheet. This, in turn, would result in a charge against earnings and, thus, a reduction in the Company s stockholders equity and certain related capital measures. During 2012, the Company recognized no goodwill impairment.

The Company may lose members of its management team and have difficulty attracting skilled personnel.

The Company s success depends, in large part, on its ability to attract and retain key people. Competition for the best people can be intense and the Company may not be able to hire such people or to retain them. The unexpected loss of services of key personnel of the Company could have a material adverse impact on its business because of their skills, knowledge of the Company s market, years of industry experience and the difficulty of promptly finding qualified replacement personnel. In addition, recent regulatory proposals and guidance relating to compensation may negatively impact the Company s ability to retain and attract skilled personnel.

An increase in FDIC deposit insurance premiums could adversely affect the Company s earnings.

Market developments have significantly depleted the DIF of the FDIC and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, the FDIC revised its assessment rates which raised deposit premiums for certain insured depository institutions. If these increases are insufficient for the DIF to meet its funding requirements, further special assessments or increases in deposit insurance premiums may be required. The Company is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures, the FDIC may increase the deposit insurance assessment rates. Any future assessments, increases or required prepayments in FDIC insurance premiums may materially adversely affect the Company s earnings and could have a material adverse effect on the value of its Common Stock.

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The Company may seek to raise additional capital in the future, and such capital may not be available on acceptable terms or at all.

The Company may seek to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments, business needs, and growth objectives, particularly if its asset quality or earnings were to deteriorate significantly. The Company s ability to raise additional capital will depend on, among other things, conditions in the capital markets at that time, which are outside of its control, and its financial performance. Economic conditions and the loss of confidence in financial institutions may increase the Company s cost of funding and limit access to certain customary sources of capital, including inter-bank borrowings, repurchase agreements and borrowings from the discount window of the FRB. Any occurrence that may limit the Company s access to the capital markets may adversely affect the Company s capital costs and its ability to raise capital and, in turn, its liquidity. Accordingly, the Company cannot provide any assurance that additional capital will be available on acceptable terms or at all. An inability to raise additional capital on acceptable terms could have a materially adverse effect on the Company s businesses, financial condition and results of operations.

Liquidity risk could impair the Company s ability to fund operations and jeopardize its financial condition.

Liquidity is essential to the Company s business. An inability to raise funds through deposits, borrowings, equity and debt offerings, and other sources could have a substantial negative effect on the Company s liquidity. The Company s access to funding sources in amounts adequate to finance its activities, or on terms attractive to the Company, could be impaired by factors that affect the Company specifically or the financial services industry in general. Factors that could detrimentally impact the Company s access to liquidity sources include a reduction in its credit ratings, if any, an increase in costs of capital in financial capital markets, a decrease in the level of its business activity due to a market downturn or adverse regulatory action against the Company, or a decrease in depositor or investor confidence. The Company s access to liquidity sources could also be impaired by factors that are not specific to it, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

The Company s controls and procedures may fail or be circumvented.

Management regularly reviews and updates the Company s internal controls over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company s controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company s business, results of operations and financial condition.

The failure of other financial institutions could adversely affect the Company.

The Company s ability to engage in routine funding transactions could be adversely affected by future failures of financial institutions and the actions and commercial soundness of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. The Company has exposure to different industries and counterparties and routinely executes transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, investment companies and other institutional clients. In certain of these transactions, the Company is required to post collateral to secure the obligations to the counterparties. In the event of a bankruptcy or insolvency proceeding involving one of such counterparties, the Company may experience delays in recovering the assets posted as collateral or may incur a loss to the extent that the counterparty was holding collateral in excess of the obligation to such counterparty.

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In addition, many of these transactions expose the Company to credit risk in the event of a default by the Company s counterparty or client. In addition, the credit risk may be exacerbated when the collateral held by the Company cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to the Company. Any losses resulting from the Company s routine funding transactions may materially and adversely affect its financial condition and results of operations.

The Company is subject to environmental liability risk associated with lending activities.

A significant portion of the Company s loan portfolio is secured by real property. During the ordinary course of business, the Company may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expenses and may materially reduce the affected property s value or limit the Company s ability to use or sell the affected property. Although the Company has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Company s financial condition and results of operations.

The Company s information systems may experience an interruption or breach in security.

The Company and the Bank rely heavily on communications and information systems to conduct its business. In addition, as part of its business, the Bank collects, processes and retains sensitive and confidential client and customer information. The Company s and the Bank s facilities and systems, and those of our third party service providers, may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human errors, or other similar events. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company s and the Bank s customer relationship management, general ledger, deposit, loan and other systems. While the Company and the Bank have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of their information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of the Company s and the Bank s information systems could damage their reputation, result in a loss of customer business, subject the Company and the Bank to regulatory scrutiny, or expose the Company and the Bank to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company s financial condition and results of operations.

The Bank s business is dependent on technology, and an inability to invest in technological improvements may adversely affect the Bank s and the Company s results of operations and financial condition.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The effective use of technology better serves customers, increases efficiency, and enables financial institutions to reduce costs. The Bank has made significant investments in data processing, management information systems and internet banking accessibility. The Bank s and the Company s future success will depend in part upon the Bank s ability to create additional efficiencies in its operations through the use of technology. Many of the Bank s competitors have greater resources to invest in technological improvements. There can be no assurance that the Bank s technological improvements will increase the Bank s operational efficiency or that the Bank will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers.

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Risks Associated with the Company s Common Stock

The Company s Common Stock price can be volatile.

Stock price volatility may make it more difficult for holders of the Company s Common Stock to resell when desired. The Company s Common Stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations.
- Recommendations by securities analysts.
- Operating and stock price performance of other companies that investors deem comparable to the Company.
- News reports relating to trends, concerns and other issues in the financial services industry.
- Perceptions in the marketplace regarding the Company and/or its competitors.
- New technology used, or services offered, by competitors.
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or its competitors.
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions.
- Changes in government regulations.
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause the Company s Common Stock price to decrease regardless of operating results.

The trading volume in the Company s Common Stock is less than that of other larger financial services companies.

Although the Company s Common Stock is listed for trading on the NASDAQ, the trading volume in its Common Stock is less than that of other, larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company s Common Stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company s Common Stock, significant sales of the Company s Common Stock, or the expectation of these sales, could cause the Company s stock price to fall.

The Company may not continue to pay dividends on its Common Stock in the future.

The Company s Common Stockholders are only entitled to receive such dividends the Company s board of directors declares out of funds legally available for such payments. Although the Company has historically declared cash dividends on its Common Stock, it is not required to do so and may reduce or eliminate its Common Stock dividend in the future. This could adversely affect the market price of the Company s Common Stock. Also, the Company is a financial holding company and its ability to declare and pay dividends is dependent on certain federal regulatory considerations, including the guidelines of the Federal Reserve Board regarding capital adequacy and dividends.

An investment in the Company s Common Stock is not an insured deposit.

The Company s Common Stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in the Company s Common

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Stock is inherently risky for the reasons described in this Risk Factors section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, holders of the Company s Common Stock could lose some or all of their investment.

Certain banking laws may have an anti-takeover effect.

Provisions of federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire the Company, even if doing so would be perceived to be beneficial to the Company s shareholders. These provisions effectively inhibit a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of the Company s Common Stock.

The Company issued Series A Preferred Stock, which ranks senior to its Common Stock.

The Company issued 18,921 shares of Series A Preferred Stock in May 2011. The Series A Preferred Stock ranks senior to shares of the Company s Common Stock. As a result, the Company must make dividend payments on its Series A Preferred Stock before any dividends can be paid on the Company s Common Stock and, in the event of its bankruptcy, dissolution or liquidation, the holders of the Series A Preferred Stock must be satisfied before any distributions can be made on the Company s Common Stock. If the Company does not remain current in the payment of dividends on the Series A Preferred Stock, no dividends may be paid on its Common Stock. In addition, the dividends declared on the Series A Preferred Stock will reduce any net income available to holders of Common Stock and earnings per common share. As of December 31, 2012, 17,421 shares of Series A Preferred Stock were outstanding.

ITEM 1B. Unresolved Staff Comments.

The Company has no unresolved staff comments as of the filing date of this 2012 Annual Report on Form 10-K.

ITEM 2. Properties.

The Company s corporate headquarters are located in Bluefield, Virginia, where the Company owns and occupies approximately 36,000 square feet of office space. In addition to its corporate headquarters, the Company operated 71 banking centers, loan production, administrative, and other financial services offices through its community bank subsidiary, First Community Bank (the Bank), at December 31, 2012, of which 50 were owned and 21 were leased or located on leased land. The banking centers were located throughout Virginia, West Virginia, North Carolina, South Carolina, and Tennessee. The Company is also the parent company of Greenpoint Insurance Group, Inc. (Greenpoint), headquartered in High Point, North Carolina, a full-service insurance agency offering commercial and personal lines of insurance. Including its headquarters, Greenpoint operated 6 insurance offices at December 31, 2012, of which 1 was owned, 3 were leased, and 2 were located within the Company s banking centers. The insurance agency offices were located throughout North Carolina, West Virginia, and Virginia. There were no mortgages or liens against any property of the Company. A complete list of all branch and ATM locations can be found on the Company s website at www.fcbinc.com. Information contained on such website is not part of this Annual Report on Form 10-K. See Note 7 Premises and Equipment of the Notes to Consolidated Financial Statements in Item 8 herein.

ITEM 3. Legal Proceedings.

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

ITEM 4. Mine Safety Disclosures.

None.

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PART II

ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.
Common Stock Market Prices and Dividends

The number of Common Stockholders of record on February 27, 2013, was 2,942 and outstanding shares totaled 20,047,484. The number of Common Stockholders is measured by the number of record holders. The Company s Common Stock trades on the NASDAQ Global Select market under the symbol, FCBC.

The Company s ability to pay dividends on its Common Stock is principally dependent on the Bank s ability to pay dividends to the Company, which is subject to various regulatory restrictions and limitations. For information on the regulatory restrictions and limitations on the ability of the Company to pay dividends to its stockholders and on the Bank to pay dividends to the Company, see Business Regulation and Supervision The Company Regulatory Restrictions on Dividends; Source of Strength. and Business Regulation and Supervision The Bank Restrictions on Distribution of Subsidiary Bank Dividends and Assets in Item 1 herein. Cash dividends on Common Stock totaled $0.43 per share for 2012 and $0.40 per share in 2011. Total dividends paid on Common Stock for the years ended December 31, 2012 and 2011, totaled $8.16 million and $7.16 million, respectively. Total cash dividends paid on the Company s Series A Preferred Stock for the years ended December 31, 2012 and 2011, totaled $1.12 million and $558 thousand, respectively.

The following table sets forth the high and low stock prices and dividends paid per share on the Company s Common Stock during the periods indicated:

	2012		2011	
	High	Low	High	Low
Sales Price Per Share				
First quarter	$ 13.85	$ 11.86	$ 15.43	$ 12.23
Second quarter	14.43	11.85	15.21	12.94
Third quarter	15.84	13.91	14.60	9.40
Fourth quarter	16.22	14.25	13.02	9.48

	2012	2011
Cash Dividends Per Share		
First quarter	$ 0.10	$ 0.10
Second quarter	0.11	0.10
Third quarter	0.11	0.10
Fourth quarter	0.11	0.10
Total	$ 0.43	$ 0.40

Information regarding compensation plans under which the Company s equity securities are authorized for issuance are hereby incorporated by reference from Item 12 of this Annual Report on Form 10-K.

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Stock Repurchase Plan

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

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Maximum Number of Shares That May Yet be Purchased Under the Plan (1)
October 1-31, 2012		$		877,577
November 1-30, 2012	49,438	14.91	49,438	828,139
December 1-31, 2012	18,000	15.26	18,000	810,139
Total	67,438	$ 15.00	67,438	

(1) The Company s stock repurchase plan, as amended, authorized 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. The Company held 289,861 shares in treasury at December 31, 2012.

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Total Return Analysis

The following chart was compiled by SNL Financial LC, and compares cumulative total shareholder return of the Company s Common Stock for the five-year period ended December 31, 2012, with the cumulative total return of the S&P 500 Index, the NASDAQ Composite Index, and the Asset Size & Regional Peer Group. The Asset Size & Regional Peer Group consists of 50 bank holding companies that are traded on the NASDAQ, OTC Bulletin Board, and pink sheets with total assets between $1 billion and $5 billion and are located in the Southeast Region of the United States. The cumulative returns include reinvestment of dividends by the Company.

	Period Ending					
Index	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**
First Community Bancshares, Inc.	100.00	113.25	40.09	51.17	44.13	58.25
S&P 500	100.00	63.00	79.68	91.68	93.61	108.59
NASDAQ Composite	100.00	60.02	87.24	103.08	102.26	120.42
Asset & Regional Peer Group(1)	100.00	94.41	69.79	74.83	66.93	76.91

(1) The Asset Size & Regional Peer Group consists of the following institutions: 1st United Bancorp, Inc., American National Bankshares, Inc., Ameris Bancorp, BancTrust Financial Group, Inc., Bank of the Ozarks, Inc., BNC Bancorp, Burke & Herbert Bank & Trust Company, Capital City Bank Group, Inc., Cardinal Financial Corporation, Carter Bank & Trust, CenterState Banks, Inc., City Holding Company, Colony Bankcorp, Inc., Eastern Virginia Bankshares, Inc., Fidelity Southern Corporation, First Bancorp, First Citizens Bancshares, Ins., First Farmers and Merchants Corporation, First Financial Holdings, Inc., First M&F Corporation, First Security Group, Inc., First Southern Bancorp, Inc., FNB United Corp., Great Florida Bank, Hamilton State Bancshares, Inc., Hampton Roads Bankshares, Inc., Home BancShares, Inc.,

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Middleburg Financial Corporation, Monarch Financial Holdings, Inc., National Bankshares, Inc., NewBridge Bancorp, Palmetto Bancshares, Inc., Park Sterling Corporation, Peoples Bancorp of North Carolina, Inc., Pinnacle Financial Partners, Inc., Premier Financial Bancorp, Inc., Renasant Corporation, SCBT Financial Corporation, Seacoast Banking Corporation of Florida, Simmons First National Corporation, Southeastern Bank Financial Corporation, Southern BancShares (N.C.), Inc., State Bank Financial Corporation, StellarOne Corporation, Summit Financial Group, Inc., TowneBank, Union First Market Bankshares Corporation, Virginia Commerce Bancorp, Inc., Wilson Bank Holding Company, and Yadkin Valley Financial Corporation. The returns of each of the foregoing institutions have been weighted according to their respective stock market capitalization at the beginning of each period for which a return is indicated.

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ITEM 6. Selected Financial Data.

The following consolidated selected financial data is derived from the Company s audited financial statements as of and for the five years ended December 31, 2012. The consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes included in this Annual Report on Form 10-K. All of the Company s acquisitions during the five years ended December 31, 2012, were accounted for using the purchase method. Accordingly, the operating results of the acquired companies are included with the Company s results of operations since their respective dates of acquisition.

	At or for the year ended December 31,				
Five-Year Selected Financial Data	**2012**	**2011**	**2010**	**2009**	**2008**
(Amounts in thousands, except per share data)					
Balance Sheet Summary (at end of period)					
Securities	$ 535,174	$ 485,920	$ 484,701	$ 493,511	$ 529,393
Loans held for sale	6,672	5,820	4,694	11,576	1,024
Loans held for investment, net of unearned income	1,724,653	1,396,067	1,386,206	1,393,931	1,298,159
Allowance for loan losses	25,770	26,205	26,482	24,277	17,782
Total assets	2,728,867	2,164,789	2,244,238	2,273,283	2,132,187
Deposits	2,030,175	1,543,467	1,620,955	1,645,960	1,503,758
Borrowings	313,553	295,141	332,087	352,558	381,791
Total liabilities	2,372,544	1,859,060	1,974,360	2,021,016	1,912,972
Preferred stock	17,421	18,921			41,500
Total stockholders equity	356,323	305,729	269,878	252,267	219,215
Summary of Earnings					
Interest income	$ 109,656	$ 94,176	$ 103,582	$ 107,934	$ 110,765
Interest expense	19,600	22,147	29,725	38,682	44,930
Net interest income	90,056	72,029	73,857	69,252	65,835
Provision for loan losses	5,678	9,047	14,757	15,801	9,226
Net interest income after provision for loan losses	84,378	62,982	59,100	53,451	56,609
Noninterest income	36,710	35,534	40,508	(53,677)	2,374
Noninterest expense	78,383	68,915	69,943	66,624	60,516
Income (loss) before income taxes	42,705	29,601	29,665	(66,850)	(1,533)
Income tax expense (benefit)	14,128	9,573	7,818	(28,154)	(3,487)
Net income (loss)	28,577	20,028	21,847	(38,696)	1,954
Dividends on preferred stock	1,058	703		2,160	255
Net income (loss) available to common shareholders	27,519	19,325	21,847	(40,856)	1,699
Per Share Data					
Basic earnings (loss) per common share	$ 1.44	$ 1.08	$ 1.23	$ (2.75)	$ 0.15
Diluted earnings (loss) per common share	$ 1.40	$ 1.07	$ 1.23	$ (2.75)	$ 0.15
Cash dividends per common share	$ 0.43	$ 0.40	$ 0.40	$ 0.30	$ 1.12
Book value per common share at year-end(2)	$ 16.76	$ 15.96	$ 15.11	$ 14.20	$ 15.36
Selected Ratios					
Return on average assets	1.10%	0.88%	0.97%	-1.83%	0.08%
Return on average common equity	8.70%	6.81%	8.11%	-16.73%	0.86%
Average equity to average assets	13.34%	13.44%	11.91%	10.95%	9.86%
Dividend payout	29.89%	37.00%	32.52%	N/M(1)	N/M(1)
Total risk-based capital ratio	16.70%	18.15%	15.33%	13.81%	12.94%
Leverage ratio	9.96%	11.50%	9.44%	8.51%	9.70%

(1) N/M Not meaningful

(2) Book value per common share at year-end is defined as stockholders equity divided by as-converted common shares outstanding

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ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.
Executive Overview

First Community Bancshares, Inc. (the Company) is a financial holding company that, through its bank subsidiary, provides commercial banking services and has positioned itself as a regional community bank and a financial services alternative to larger banks which often provide less emphasis on personal relationships, and smaller community banks which lack the capital and resources to efficiently serve customer needs. The Company has focused its growth efforts on building financial partnerships and more enduring and complete relationships with businesses and individuals through a very personal and local approach to banking and financial services. The Company and its operations are guided by a strategic plan which includes growth through acquisitions and through office expansion in market areas including Virginia, West Virginia, North Carolina, South Carolina, and Tennessee. While the Company s mission remains that of a community bank, management believes that entry into new markets will accelerate the Company s growth rate by diversifying the demographics of its customer base and customer prospects and by generally increasing its sales and service network.

Economy

The local economies in which the Company operates are diverse and span a five-state region. The economies of West Virginia and Southwest Virginia have significant exposure to extractive industries, such as coal, timber and natural gas. The local economies in the central portion of North Carolina have suffered in recent years due to foreign competition in both furniture and textiles, as well as consolidation in the financial services industry. Despite these detractions, the economies in this region continue to benefit from national companies operating in the Triad and Central Piedmont area of North Carolina. The Eastern Virginia local economies have, in recent years, benefited from key corporate and government activities. The economy in Eastern Tennessee continues to benefit from the stability of higher education, healthcare services, and tourism. The local economies in the northeastern portion of South Carolina and the southeastern portion of North Carolina benefit from tourism and military activities.

Despite the stable and positive aspects of the regional economies the Company primarily operates in, these markets have experienced significant declines in residential development and construction which are consistent with national trends. These declines have led to contraction in residential land development and construction, which has historically been important components of the Company s lending activities. The economies of the Company s Southwest Virginia and West Virginia markets have remained stable compared with the national economy and unemployment levels were generally lower than the national average at December 31, 2012.

Competition

As the Company competes for increased market share and growth in both loans and deposits, it continues to encounter strong competition from many sources. Many of the markets targeted by the Company are also being entered by other banks in nearby and distant markets. The expansion of banks, credit unions, and other non-depository financial companies over recent years has intensified competitive pressures on core deposit generation and retention. Competitive forces impact the Company through pressure on interest yields, product fees, and loan structure and terms; however, the Company has countered these pressures with its relationship style of banking, competitive pricing, cost efficiencies, and a disciplined approach to loan underwriting.

Application of Critical Accounting Policies

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

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

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

Investment Securities

Management performs an extensive review of the investment securities portfolio quarterly to determine the cause of declines in the fair value of each security within each segment of the portfolio. The Company uses inputs provided by an independent third party to determine the fair values of its investment securities portfolio. Inputs provided by the third party are reviewed and corroborated by management. Evaluations of the causes of the unrealized losses are performed to determine whether the impairment is temporary or other-than-temporary in nature. Considerations such as the Company s intent and ability to hold the securities, recoverability of the invested amounts over the Company s intended holding period, severity in pricing decline, credit rating, and receipt of amounts contractually due, among other factors, are applied in determining whether a security is other-than-temporarily impaired. If a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Allowance for Loan Losses

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

The Company determines the allowance for loan losses by making specific allocations to impaired loans that exhibit inherent weaknesses and various credit risk and by general allocations to commercial, residential real estate, and consumer loans by giving weight to risk ratings, historical loss trends and management s judgment concerning those trends, and other relevant factors. These factors may include, but are not limited to, actual versus estimated losses, regional and national economic conditions, business segment and portfolio concentrations, industry competition and consolidation, and the impact of government regulations. The foregoing analysis is performed by management to evaluate the portfolio and calculate an estimated valuation allowance through a quantitative and qualitative analysis that applies risk factors to those identified risk areas.

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

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

Acquisitions and Intangible Assets

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

Management must also make estimates of useful or economic lives of certain acquired assets and liabilities. These lives are used in establishing amortization and accretion of some intangible assets and liabilities, such as the intangible associated with core deposits acquired in the acquisition of a commercial bank.

Goodwill is recorded as the excess of the purchase price, if any, over the fair value of the acquired net assets and is allocated to reporting units at acquisition. Goodwill is tested annually in the fourth quarter for possible impairment by comparing the fair value of each reporting unit to its book value, including goodwill (step 1). If the fair value of the reporting unit is greater than its book value, no goodwill impairment exists. However, if the book value of the reporting unit is greater than its determined fair value, goodwill impairment may exist and further testing is required to determine the amount, if any, of the actual impairment loss (step 2). The step 1 test utilizes a combination of two methods to determine the fair value of the reporting units. The Company maintains two reporting units, Community Banking and Insurance Services. For both reporting units, a discounted cash flow model is created projecting cash flows from operations of the business reporting unit, the results of which are weighted 70%. For the Community Banking reporting unit a market multiple model utilizes price to net income and price to tangible book value inputs for closed transactions and for certain common sized institutions and the results are weighted 30%. For the Insurance Services reporting unit the market multiple model primarily utilizes price to sales for closed transactions and certain similar industry public companies and the results are weighted 30%. The end results for both reporting units are then compared to the respective book values to consider if impairment is evident. To determine the overall reasonableness of the reporting unit computations, the combined computed fair value is then compared to the overall market capitalization of the consolidated Company to determine the level of implied control premium.

The discounted cash flow analysis uses estimates in the form of growth and attrition rates, anticipated rates of return, and discount rates. These estimates have a direct bearing on the results of the impairment testing and serve as the basis for management s conclusions as to potential impairment.

The results of the step 1 analysis performed during the fourth quarter of 2012 determined that no impairment was evident for either reporting unit.

Income Taxes

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

Deferred tax assets and liabilities are recognized for the tax effects of differing carrying values of assets and liabilities for tax and financial statement purposes that will reverse in future periods. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. When uncertainty exists concerning the recoverability of a deferred tax asset, the carrying value of the asset may be reduced by a valuation allowance. The amount of any valuation allowance established is based upon an estimate of the deferred tax asset that is more likely than not to be recovered. Increases or decreases in the valuation allowance result in increases or decreases to the provision for income taxes.

Recent Acquisitions and Divestitures

On June 8, 2012, the Company entered into a purchase and assumption agreement with loss share arrangements with the Federal Deposit Insurance Corporation (FDIC) to purchase certain assets and assume substantially all of the customer deposits and certain liabilities of Waccamaw Bank (Waccamaw). 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 $500.64 million, loans of approximately $318.35 million, and deposits of approximately $414.13 million. As a result of the acquisition and the preliminary purchase price allocation, approximately $10.90 million was recorded as goodwill, which represents the excess of the value of the consideration transferred over the fair value of the net assets acquired including indentified intangibles. 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. After the initial acquisition, the Company agreed to purchase four properties totalling $1.80 million from the FDIC.

On May 31, 2012, the Company completed the acquisition of Peoples Bank of Virginia (Peoples), based in Richmond, Virginia. Peoples, a full service community bank, operated four branches throughout the Richmond area. At acquisition, Peoples had total assets of approximately $275.76 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 $10.21 million was recorded as goodwill, which represents the excess of the value of the consideration transferred over the fair market value of the net assets acquired including indentified intangibles. 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.

Greenpoint Insurance Group (Greenpoint), a wholly-owned subsidiary of the Company, has acquired seven insurance agencies and sold three since its acquisition by the Company in September 2007. During 2012, Greenpoint did not acquire or sell any insurance agencies; however, $366 thousand was received from earn-out payments related to agency sales in 2011. During 2011, Greenpoint received aggregate cash of $1.58 million from the sale of two insurance agencies. During 2010, Greenpoint paid aggregate cash consideration of $190 thousand in connection with the acquisition of one insurance agency.

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Results of Operations

2012 Compared To 2011

Net income increased $8.55 million, or 42.69%, to $28.58 million for the year ended December 31, 2012, compared with $20.03 million for the year ended December 31, 2011. Net income available to common shareholders increased $8.19 million, or 42.40%, to $27.52 million for the year ended December 31, 2012, compared with $19.33 million for the same period of 2011. Basic and diluted earnings per common share for year-end 2012 were $1.44 and $1.40, respectively, as compared to basic and diluted earnings per common share for year-end 2011 of $1.08 and $1.07, respectively. Return on average assets was 1.10% in 2012 compared to 0.88% in 2011. Return on average common equity was 8.70% in 2012 compared to 6.81% in 2011.

Net Interest Income

Net interest income, the largest contributor to earnings, increased $18.03 million, or 25.03%, for the year ended December 31, 2012, compared with the same period of 2011. Tax equivalent net interest income increased $17.82 million, or 23.76%, for the year ended December 31, 2012, compared with the same period 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.

For purposes of this discussion, net interest income is presented on a tax equivalent basis to provide a comparison among all types of interest earning assets. The tax equivalent basis adjusts for the tax-favored status of income from certain loans and investments. Although this is a non-GAAP measure, management believes this measure is more widely used within the financial services industry and provides better comparability of net interest income arising from taxable and tax-exempt sources. We use this measure to monitor net interest income performance and to manage its balance sheet composition (see the table titled Average Balance Sheets and Net Interest Income Analysis).

Average earning assets increased $257.70 million and average interest-bearing liabilities increased $190.79 million during 2012, as compared to the prior year. The yield on average earning assets increased 11 basis points to 5.12% during 2012 from 5.01% at year-end 2011. The rate on average interest-bearing liabilities decreased 27 basis points to 1.05% during 2012 from 1.32% at year-end 2011. Average balances and interest yield/rate changes for earning assets and interest-bearing liabilities resulted in a net interest rate spread that was 38 basis points higher for year-end 2012 compared with the same period of 2011. Our net interest margin increased 36 basis points for year-end 2012, compared with the same period of 2011.

The tax equivalent yield on loans increased 17 basis points for the year ended December 31, 2012, compared with the same period of 2011. Tax equivalent loan interest income increased $17.82 million, or 23.76%, for the year ended December 31, 2012, compared with the same period of 2011. The increase in interest income on loans was primarily due to the Peoples and Waccamaw acquisitions. The Company expects that the effects of the interest accretion will be significantly lessened in future periods.

The tax equivalent yield on available-for-sale securities decreased 61 basis points for the year ended December 31, 2012, compared with the same period of 2011. The decrease was largely due to the new investment 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 8 basis points for the year ended December 31, 2012, compared with the same period 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 $28.76 million, or 10.37%, and the average rate paid on those deposits decreased 10 basis points for the year ended December 31, 2012, compared with the same period of 2011. The average balance of savings deposits increased $61.17 million, or 14.91%, and the average rate paid on those deposits decreased 10 basis points for the year ended December 31, 2012, compared with the same period of 2011. The average balance of time deposits increased $93.90 million, or 13.75%, and the average rate paid on those deposits decreased 49 basis points for the year ended December 31, 2012, compared with the same period of 2011. The average balance of noninterest-bearing demand deposits increased $63.72 million, or 28.54%, for the year ended December 31, 2012, compared with the same period of 2011. These increased balances during the year ended December 31, 2012, were primarily due to the Peoples and Waccamaw acquisitions.

The average balance of federal funds purchased increased $413 thousand to $490 thousand for year-end 2012 compared to $77 thousand for the same period of 2011. The average balance of retail repurchase agreements, including collateralized retail deposits and commercial treasury accounts, decreased $4.96 million, or 5.93%, and the average rate paid on those funds decreased 8 basis points for the year ended December 31, 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, which were slightly offset by the Peoples and Waccamaw acquisitions. The average balance of wholesale repurchase agreements increased $5.16 million, or 10.33%, and the average rate paid on those funds decreased 10 basis points for the year ended December 31, 2012, compared with the same period of 2011. The average balance of FHLB advances and other borrowings increased $6.35 million, or 3.75%, and the average rate paid on those funds decreased 2 basis point for the year ended December 31, 2012, compared with the same period of 2011.

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Average Balance Sheets and Net Interest Income Analysis

	2012			2011			2010		
(Amounts in thousands)	Average Balance	Interest Income/ Expense (1)	Average Yield/Rate (1)	Average Balance	Interest Income/ Expense (1)	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense (1)	Average Yield/ Rate (1)
Earning assets									
Loans held for investment (2)	$ 1,611,557	$ 96,803	6.01%	$ 1,382,097	$ 80,742	5.84%	$ 1,400,061	$ 84,906	6.06%
Available-for-sale securities	502,416	15,170	3.02%	434,583	15,775	3.63%	492,703	21,313	4.33%
Held-to-maturity securities	2,622	171	6.52%	3,999	333	8.32%	6,299	533	8.46%
Interest-bearing deposits with banks	77,851	259	0.33%	116,063	285	0.25%	81,987	194	0.24%
Total earning assets	2,194,446	$ 112,403	5.12%	1,936,742	$ 97,135	5.01%	1,981,050	$ 106,946	5.40%
Other assets	316,485			258,897			282,005		
Total	$ 2,510,931			$ 2,195,639			$ 2,263,055		
Interest-bearing liabilities									
Demand deposits	$ 306,019	$ 185	0.06%	$ 277,263	$ 431	0.16%	$ 252,471	$ 980	0.39%
Savings deposits	471,406	556	0.12%	410,240	886	0.22%	421,184	2,751	0.65%
Time deposits	776,901	9,231	1.19%	682,997	11,471	1.68%	760,286	16,156	2.12%
Total interest-bearing deposits	1,554,326	9,972	0.64%	1,370,500	12,788	0.93%	1,433,941	19,887	1.39%
Federal funds purchased	490	2	0.41%	77		0.00%			
Retail repurchase agreements	78,608	449	0.57%	83,564	544	0.65%	97,531	992	1.02%
Wholesale repurchase agreements	55,163	2,023	3.67%	50,000	1,887	3.77%	50,000	1,872	3.74%
FHLB borrowings and other long-term debt	175,333	7,154	4.08%	168,988	6,928	4.10%	194,461	6,974	3.59%
Total borrowings	309,594	9,628	3.11%	302,629	9,359	3.09%	341,992	9,838	2.88%
Total interest-bearing liabilities	1,863,920	19,600	1.05%	1,673,129	22,147	1.32%	1,775,933	29,725	1.67%
Noninterest-bearing demand deposits	286,950			223,233			206,396		
Other liabilities	25,160			4,127			11,280		
Stockholders equity	334,901			295,150			269,446		
Total	$ 2,510,931			$ 2,195,639			$ 2,263,055		
Net interest income, tax-equivalent		$ 92,803			$ 74,988			$ 77,221	
Net interest rate spread (3)			4.07%			3.69%			3.73%
Net interest margin (4)			4.23%			3.87%			3.90%

(1) Fully taxable equivalent at the rate of 35% (FTE).
(2) Non-accrual loans are included in average balances outstanding but with no related interest income during the period of non-accrual.
(3) Represents the difference between the tax equivalent yield on earning assets and cost of funds.
(4) Represents tax-equivalent net interest income divided by average interest earning assets.

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Rate and Volume Analysis of Interest

The following table summarizes the changes in 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):

	Twelve Months Ended December 31, 2012 Compared to 2011 Dollar Increase/(Decrease) due to				Twelve Months Ended December 31, 2011 Compared to 2010 Dollar Increase/(Decrease) due to			
(Amounts in thousands)	**Volume**	**Rate**	**Rate/ Volume**	**Total**	**Volume**	**Rate**	**Rate/ Volume**	**Total**
Interest Earned On:								
Loans (FTE)	$ 13,401	$ 2,349	$ 311	$ 16,061	$ (1,089)	$ (3,080)	$ 5	$ (4,164)
Securities available-for-sale (FTE)	2,462	(2,651)	(416)	(605)	(2,517)	(3,449)	428	(5,538)
Securities held-to-maturity (FTE)	(115)	(72)	25	(162)	(195)	(8)	3	(200)
Interest-bearing deposits with other banks	(95)	93	(24)	(26)	82	8	1	91
Total interest-earning assets	15,653	(281)	(104)	15,268	(3,719)	(6,529)	437	(9,811)
Interest Paid On:								
Demand deposits	46	(277)	(15)	(246)	97	(581)	(65)	(549)
Savings deposits	134	(410)	(54)	(330)	(71)	(1,811)	17	(1,865)
Time deposits	1,578	(3,347)	(471)	(2,240)	(1,639)	(3,345)	299	(4,685)
Federal funds purchased		0	2	2				
Retail repurchase agreements	(32)	(67)	4	(95)	(142)	(361)	55	(448)
Wholesale repurchase agreements	195	(50)	(9)	136		15	0	15
FHLB borrowings and other long-term debt	260	(34)	(0)	226	(914)	992	(124)	(46)
Total interest-bearing liabilities	2,181	(4,185)	(543)	(2,547)	(2,669)	(5,091)	182	(7,578)
Change in net interest income, tax-equivalent	$ 13,472	$ 3,904	$ 439	$ 17,815	$ (1,050)	$ (1,438)	$ 255	$ (2,233)

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 $3.37 million for the year ended December 31, 2012, compared with the same period of 2011, which was primarily due to a continued general downward trend in net non-covered 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 $6.11 million for the year ended December 31, 2012, compared with $9.32 million for the same period of 2011. Net charge-offs as a percentage of average non-covered loans was 0.41% for the year ended December 31, 2012, compared with 0.67% for the same period of 2011. Non-covered loans exclude loans acquired in the Waccamaw transaction that are covered under the FDIC loss share agreements. See Financial Position Allowance for Loan Losses for additional information.

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Noninterest Income

Noninterest income increased $1.18 million, or 3.31%, for the year ended December 31, 2012, compared with the same period of 2011. Exclusive of the impact of OTTI charges, the gain on the sale of securities, and an out-of-period adjustment, noninterest income increased $2.22 million, or 6.82%, to $34.77 million for the year ended December 31, 2012, compared with $32.56 million for the same period of 2011.

Wealth management revenues increased $191 thousand, or 5.44%, for the year ended December 31, 2012, compared with the same period of 2011. Service charges on deposit accounts increased $825 thousand, or 6.23%, for the year ended December 31, 2012, compared with the same period of 2011, due to the Waccamaw acquisition. Other service charges, commissions, and fees increased $740 thousand, or 12.93%, for the year ended December 31, 2012, compared with the same period of 2011. Insurance commissions decreased $454 thousand, or 7.33%, for the year ended December 31, 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, commissions earned during the first nine months of 2011 include the agency offices sold as part of strategic realignment during the third quarter of 2011.

During the third quarter of 2012, the Company discovered certain overstatements of loan charge-offs reported in prior periods beginning in 2007 which resulted from not recognizing the impact of interest payments that had been applied to principal for loans that were on non-accrual status. The error was discovered during the Company s core system conversion completed during the third quarter of 2012. The overstatements of charge-offs resulted in an overstatement of provision for loan losses and corresponding understatement of pre-tax income that totaled $321 thousand, $639 thousand, and $938 thousand for the years ended December 31, 2009, 2010, and 2011, respectively. The total periodic charge-off overstatements from 2007 to year-end 2011 approximated $2.39 million. Management analyzed the error to determine if any of the prior years were materially misstated and determined that they were not. Management also determined that correcting the error in the current year would not materially misstate the current year s results. The Company recorded the correction of understated pre-tax income for the prior periods in the quarter ended September 30, 2012, through an increase to other income in the amount of $2.39 million.

Other operating income increased $3.31 million, or 85.19%, for the year ended December 31, 2012, compared with the same period of 2011. Exclusive of the $2.39 million out-of-period adjustment, other operating income increased $917 thousand, or 23.59%, for the year ended December 31, 2012, compared with the same period of 2011. We incurred OTTI charges of $942 thousand for the year ended December 31, 2012, compared to $2.29 million for the same period of 2011, which were related to a non-Agency MBS. The net gain on sale of securities decreased $4.78 million, or 90.82%, for the year ended December 31, 2012, compared with the same period of 2011. See Note 3 Investment Securities of the Notes to Consolidated Financial Statements in Item 8 herein.

Noninterest Expense

Noninterest expense increased $9.47 million, or 13.74%, for the year ended December 31, 2012, compared with the same period of 2011. Salaries and employee benefits increased $4.54 million, or 13.31%, for the year ended December 31, 2012, compared with the same period of 2011. The Peoples and Waccamaw acquisitions completed during the second quarter of 2012 accounted for an increase in salaries and employee benefits of $3.80 million for year-end 2012. Incentive compensation costs increased $1.94 million and SERP expense increased $379 thousand, while medical insurance expenses decreased $1.56 million. The decrease in medical insurance expenses was due to lower claims. We also deferred $349 thousand less in direct loan origination costs during 2012 primarily due to lower origination volumes. At December 31, 2012, we had 760 full-time equivalent employees compared to 633 at December 31, 2011. Full-time equivalent employees are calculated using the number of hours worked. The Peoples and Waccamaw acquisitions resulted in the addition of 101 full-time equivalent employees for the period ended December 31, 2012. Greenpoint accounted for 46 full-time equivalent employees at year-end 2012 compared to 48 at year-end 2011. Total full-time equivalent employees at the Bank and its investment advisory firm totaled 714 at December 31, 2012, an increase of 129 full-time equivalent employees since December 31, 2011.

Occupancy, furniture, and equipment expense increased $1.25 million, or 12.76%, to $11.02 million for the year ended December 31, 2012, compared with $9.77 million for the same period of 2011 primarily as a result of the Peoples and Waccamaw acquisitions. FDIC premiums and assessments decreased $372 thousand, or 18.75%, for the year ended December 31, 2012, compared with the same period of 2011 as a result of modifications in the FDIC s assessment methodology in 2011. We incurred $5.09 million in merger related costs for the year ended December 31, 2012, in connection with the Peoples and Waccamaw acquisitions. Other operating expense increased $885 thousand, or 4.36%, for the year ended December 31, 2012, compared with the same period of 2011. The increase in other operating expense was primarily attributable to our expanded branch network and associated costs with the Waccamaw acquisition in the areas of legal expense, consulting fees, and travel related expenses. Contributing to the increase in other operating expense were increases in other service fees, office supplies expense, legal expenses, and consulting fees of $559 thousand, $466 thousand, $449 thousand, and $348 thousand, respectively. These increases were partially offset by a decreases in advertising expenses of $262 thousand. These increases were also offset by a $1.19 million decrease in expenses and losses associated with other real estate owned (OREO) to $1.89 million for the year ended December 31, 2012, compared with $3.08 million for the year ended December 31, 2011.

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

In general, our efficiency ratio is noninterest expenses as a percentage of net interest income plus noninterest income. Noninterest expenses used in the calculation exclude nonrecurring expenses. Income for the ratio is increased for the favorable effect of tax-exempt income (see Average Balance Sheets and Net Interest Income Analysis) and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses; nonrecurring gains and losses; and OTTI charges. The measure is different from the GAAP-based efficiency ratio that is calculated using noninterest expense and income amounts as shown on the face of the Consolidated Statements of Income. Both types of efficiency ratio calculations are set forth and are reconciled in the table below.

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The (non-GAAP) efficiency ratios for continuing operations for 2012, 2011, and 2010 were 55.96%, 59.56%, and 60.29%, respectively. The following table details the components used in the calculation of the efficiency ratios:

(Amounts in thousands)	2012	2011	2010
GAAP-based efficiency ratio			
Noninterest expense	$ 78,383	$ 68,915	$ 69,943
Net interest income plus noninterest income	$ 126,766	$ 107,563	$ 114,365
GAAP-based efficiency ratio	61.83%	64.07%	61.16%
Non-GAAP efficiency ratio			
Noninterest expenses GAAP-based	$ 78,383	$ 68,915	$ 69,943
Less non-GAAP adjustments:			
Foreclosed property expense and net loss	(1,893)	(3,081)	(2,802)
Prepayment penalties on FHLB advances		(471)	
Merger related expenses	(5,093)		
Goodwill impairment		(1,239)	(1,039)
Other non-core, non-recurring expense items		(77)	(4)
Adjusted non-interest expenses	$ 71,397	$ 64,047	$ 66,098
Net interest income plus noninterest income GAAP-based	$ 126,766	$ 107,563	$ 114,365
Plus non-GAAP adjustment:			
Tax equivalency adjustment	2,747	2,959	3,364
Less non-GAAP adjustments:			
Net gains on sale of securities	(483)	(5,264)	(8,273)
Net impairment losses recognized in earnings	942	2,285	185
Prospective correction of prior period understatment	(2,395)		
Other non-core, non-recurring income items		(18)	
Adjusted net interest income plus noninterest income	$ 127,577	$ 107,525	$ 109,641
Non-GAAP efficiency ratio	55.96%	59.56%	60.29%

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 $14.13 million for the year ended December 31, 2012, compared to $9.57 million for the same period of 2011. The effective tax expense rates for the years ended December 31, 2012 and 2011 were 33.08% and 32.34%, respectively. The increase in the effective tax rate is largely due to an increase in taxable revenues as a percent of net earnings and a decrease in the relative amounts of nontaxable revenues.

2011 Compared To 2010

Net income available to common shareholders for 2011 was $19.33 million, a decrease of $2.52 million from $21.85 million in 2010. Basic and diluted earnings per common share for 2011 were $1.08 and $1.07, respectively, as compared to basic and diluted earnings per common share of $1.23 in 2010. Return on average assets was 0.88% in 2011 compared to 0.97% in 2010. Return on average common equity was 6.81% in 2011 compared to 8.11% in 2010.

Net Interest Income

Net interest income was $72.03 million for 2011, as compared to $73.86 million for 2010, a decrease of $1.83 million, or 2.48%. Tax equivalent net interest income totaled $74.99 million for 2011, a decrease of $2.23 million, or 2.89%, from $77.22 million reported for 2010. The decrease in tax equivalent net interest income was primarily due to decreases in the balances of loans and securities coupled with lower rates of interest earned on those assets.

For purposes of the following discussion, comparison of net interest income is performed on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those assets which are fully taxable (see the table titled Average Balance Sheets and Net Interest Income Analysis).

Average earning assets decreased $44.31 million while average interest-bearing liabilities decreased $102.80 million during 2011, as compared to the prior year. The yield on average earning assets decreased 39 basis points to 5.01% for 2011 from 5.40% for 2010. Short-term market interest rates continued to remain low throughout 2011, as the Federal Reserve Board held the range of zero to 25 basis points as its target for federal funds. The prevailing low interest rate environment was the largest driver in the overall decrease in our yield on average earning assets.

Total cost of average interest-bearing liabilities decreased 35 basis points to 1.32% during 2011. Our time deposit portfolio experienced downward repricing during 2011, as many of the higher-rate certificates were redeemed or renewed at lower rates. The net result was a decrease of 4 basis points in the net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities, for 2011 compared to 2010. The net interest rate spread for 2011 was 3.69% compared to 3.73% for 2010. Net interest margin, or net interest income to average earning assets, of 3.87% for 2011 represents a decrease of 3 basis points from 3.90% in 2010.

Loan interest income decreased $4.16 million during 2011, as compared to 2010 as the average volume and the yield on loans decreased. During 2011, the yield on loans decreased 22 basis points to 5.84% while the average balance decreased $17.96 million, as compared to 2010. During 2011, the yield on available-for-sale securities decreased 70 basis points to 3.63% while the average balance decreased $58.12 million, as compared to 2010.

Average interest-bearing balances we maintained with third party banks increased $34.08 million during 2011 to $116.06 million, while the yield increased 1 basis point to 0.25% during the same period. Interest-bearing balances with third party banks are comprised largely of excess liquidity bearing overnight market rates.

The average balance of interest-bearing deposits decreased $63.44 million, or 4.42%, and the average rate paid on those deposits decreased 46 basis points to 0.93% during 2011 compared to the prior year. The average rate paid on interest-bearing demand deposits decreased 23 basis points, while the average rate paid on savings deposits, which include money market and savings accounts, decreased 43 basis points in 2011 compared to 2010. In 2011, average time deposits decreased $77.29 million, or 10.17%, and the average rate paid on those deposits decreased 44 basis points to 1.68%, as compared to 2010. The decrease can be attributed to rate sensitive customers not renewing investments at lower interest rates. The level of average noninterest-bearing demand deposits increased $16.84 million to $223.23 million in 2011 compared to the prior year.

The average balance of retail repurchase agreements, which consists of collateralized retail deposits and commercial treasury accounts, decreased $13.97 million in 2011 and the average rate paid on those funds decreased 37 basis points to 0.65% during the same period. The average balance of federal funds purchased totaled $77 thousand in 2011. The average balance of wholesale repurchase agreements remained unchanged at $50.0 million between 2011 and 2010, while the rate increased 3 basis points due to structure within those borrowings. The average balance of Federal Home Loan Bank (FHLB) advances and other borrowings decreased $25.47 million, or 13.10%, and the rate paid on those borrowings increased 51 basis points in 2011 compared to 2010. Other borrowings include our trust preferred issuance of $15.46 million, which is indexed to 3-month LIBOR. We prepaid $25.0 million of a $75.0 million FHLB convertible advance that carried a 4.0% interest rate during the first quarter of 2011. The advance was a structured borrowing where the interest rate floated with 3-month LIBOR, but changed to a 4.0% fixed cost in the first quarter of 2011.

Provision for Loan Losses

The provision for loan losses for 2011 was $9.05 million, a decrease of $5.71 million compared to 2010. The decrease in the loan loss provision is primarily attributed to decreasing net charge-offs during 2011; however, qualitative risk factors for the loan portfolio remained high, reflective of the elevated risk of inherent loan losses due to continued high unemployment, recessionary pressures, and devaluations of various categories of collateral. Net charge-offs for 2011 and 2010 were $9.32 million and $12.55 million, respectively. Net charge-offs, as a percentage of average loans, decreased to 0.67% for 2011 from 0.90% for 2010. See Financial Position Allowance for Loan Losses for additional information.

Noninterest Income

Noninterest income consists of all revenues that are not included in interest and fee income related to earning assets. Noninterest income for 2011, exclusive of the impact of OTTI charges and gains on the sale of securities, was $32.56 million compared to $32.42 million in 2010, an increase of $135 thousand, or 0.42%. See Financial Position Available-for-Sale Securities for information relating to our securities.

Wealth management income, which includes fees for trust services and commission and fee income generated for investment advisory services, decreased $318 thousand in 2011 to $3.51 million compared to 2010, as a result of a decrease in advisory service revenue. Service charges on deposit accounts increased $110 thousand in 2011 to $13.24 million compared to 2010, as a result of an increase in non-sufficient funds fee income. Other service charges, commissions and fees reflected an increase of $648 thousand in 2011 compared to 2010, primarily due to a continued increase in debit card interchange income as our customers increasingly chose card-based payment delivery systems.

Insurance commissions earned in 2011 were $6.20 million compared to $6.73 million in 2010, a decrease of $530 thousand, as a result of the sale of two agency offices and continued soft conditions impacting policy and premium levels. Revenue for the insurance subsidiary is derived primarily from commissions earned on the sale of property and casualty policies.

Other operating income for 2011 was $3.89 million, an increase of $225 thousand from 2010. The largest components of the increase in other operating income for 2011 were increased revenue from secondary market mortgage operations of $132 thousand, increased bank-owned life insurance income of $102 thousand, increased rental income of $92 thousand, and net gains recognized on the sale of insurance agency offices and accounts of $67 thousand.

During 2011we recognized net securities gains of $5.26 million, a decrease of $3.01 million from net securities gains of $8.27 million recognized in 2010.

Noninterest Expense

Total noninterest expense was $68.92 million for 2011, a decrease of $1.03 million from 2010. Salaries and benefits decreased $402 thousand in 2011 compared to 2010. At December 31, 2011, we had total full-time equivalent employees of 633 compared to 683 at December 31, 2010. Full-time equivalent employees are

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calculated using the number of hours worked. Greenpoint accounted for 48 full-time equivalent employees at year-end 2011 compared to 59 at year-end 2010. Total full-time equivalent employees at the Bank and its investment advisory firm totaled 585 at December 31, 2011, a decrease of 39 full-time equivalent employees since December 31, 2010. Medical insurance costs increased $517 thousand, or 17.38%, and 401(k) employer matching costs increased $217 thousand, or 19.34%. We also deferred $269 thousand less in direct loan origination costs than in 2010 primarily due to lower origination volumes.

Occupancy, furniture, and equipment expenses decreased $381 thousand in 2011 to $9.77 million, as compared to $10.15 million in 2010, due to branch closings and insurance agency sales.

FDIC premiums and assessments totaled $1.98 million in 2011, a decrease of $872 thousand compared to 2010. The decrease is attributed to modifications in the FDIC s assessment methodology in April 2011 that changed the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average tangible equity.

Other operating expenses decreased $32 thousand in 2011 to $20.31 million, as compared to 2010. Contributing to the reduction in other operating expenses were decreases in professional accounting fees, service fees, and regulatory assessments of $553 thousand, $373 thousand, and $211 thousand, respectively. These decreases were partially offset by increases in interchange expenses, consulting fees, communications expenses, and legal fees of $267 thousand, $151 thousand, $148 thousand, and $107 thousand, respectively. Also included in other operating expenses was a $362 thousand increase in losses and other expenses related to foreclosed properties, which was $3.44 million in 2011 compared to $3.08 million in 2010. As of December 31, 2011, we recognized a goodwill impairment of $1.24 million in the insurance reporting unit. Despite strong operating performance and positive market experience in sales of our non-core agencies, market multiples and other valuation indicators remained depressed resulting in a lower valuation of the insurance reporting unit.

Income Tax Expense

Consolidated income taxes for 2011 were $9.57 million compared to income taxes of $7.82 million in 2010. For the years ended December 31, 2011 and 2010, the effective tax expense rates were 32.34% and 26.35%, respectively. The increase in the effective rate can be attributed to a reduction in the impact of both tax exempt income and state income taxes combined with a reduction in 2010 income tax expense necessary to reconcile our reported tax expense with the actual expense as presented in our 2009 tax return filed with the Internal Revenue Service and state taxation authorities.

Financial Position

Available-for-Sale Securities

Available-for-sale securities as of December 31, 2012, increased $51.93 million, or 10.76%, compared with December 31, 2011. The market value of securities available-for-sale as a percentage of amortized cost improved to 99.92% at December 31, 2012, compared with 98.13% at December 31, 2011, as a result of improved pricing on certain issues. At December 31, 2012, the average life and duration of the portfolio were 7.25 years and 6.14, respectively. Average life and duration at December 31, 2011, were 7.35 years and 6.02, respectively.

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible OTTI. This review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, timing and amount of contractual cash flows, the expectation for that security s performance, the creditworthiness of the issuer and our intent to hold the security to recovery or maturity. If a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. In the instance of a debt security which is determined to be other-than-temporarily impaired, we determine the amount of the impairment due to credit and the amount due to other factors. The amount of impairment related to credit is recognized in the Consolidated Statements of Income and the remainder of the impairment is recognized in other comprehensive income.

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During the year ended December 31, 2012, we recognized OTTI charges in earnings of $942 thousand compared to $2.29 million recognized during the same period of 2011, which were related to a non-Agency Alt-A residential mortgage-backed security. We recognized no impairment charges on equity securities during 2012 or 2011. At December 31, 2012, our investment in single issue trust preferred securities was comprised of investments in five of the nation s largest bank holding companies.

The following table details amortized cost and fair value of available-for-sale securities at December 31, 2012, 2011, and 2010:

	2012		2011		2010	
(Amounts in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
U.S. Government agency securities	$	$	$	$	$ 10,000	$ 9,832
States and political subdivisions	151,119	159,217	131,498	137,815	178,149	176,138
Trust preferred securities:						
Single issue	55,707	44,646	55,649	40,244	55,594	41,244
Pooled					23	264
Total trust preferred securites	55,707	44,646	55,649	40,244	55,617	41,508
Corporate FDIC insured securities			13,685	13,718	25,282	25,660
Mortgage-backed securities:						
Agency	310,323	315,897	274,384	280,102	209,281	215,013
Non-Agency Alt-A residential	14,215	11,067	15,980	10,030	19,181	11,277
Total mortgage-backed securities	324,538	326,964	290,364	290,132	228,462	226,290
Equity securities	3,446	3,531	419	521	495	636
Total	$ 534,810	$ 534,358	$ 491,615	$ 482,430	$ 498,005	$ 480,064

Held-to-Maturity Securities

Investment securities classified as held-to-maturity are comprised primarily of high grade municipal bonds. Held-to-maturity securities as of December 31, 2012, decreased $2.67 million, or 76.62%, compared with December 31, 2011. The market value of securities held-to-maturity as a percentage of amortized cost improved to 101.96% at December 31, 2012, compared with 101.20% at December 31, 2011.

The following table details amortized cost and fair value of held-to-maturity securities at December 31, 2012, 2011, and 2010:

	2012		2011		2010	
(Amounts in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
States and political subdivisions	$ 816	$ 832	$ 3,490	$ 3,532	$ 4,637	$ 4,704
Total	$ 816	$ 832	$ 3,490	$ 3,532	$ 4,637	$ 4,704

Loans Held for Sale

Loans held for sale as of December 31, 2012, increased $852 thousand, or 14.64% 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 the interest rate risk involved in these commitments. The gross notional amount of outstanding commitments related to secondary market mortgage loans at December 31, 2012, was $14.84 million for 88 loans compared to $9.15 million for 53 loans at December 31, 2011.

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Loans Held for Investment

Loans held for investment as of December 31, 2012, increased $328.59 million, or 23.54%, compared with December 31, 2011. The increase was primarily due to the Peoples and Waccamaw acquisitions. Average loans held for investment as of December 31, 2012, increased $229.46 million, or 16.60%, compared with December 31, 2011. The average loan to deposit ratio was 87.52% for the year ended December 31, 2012, compared to 86.72% for the same period 2011. The held for investment loan portfolio continues to be well diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition for the five years ended December 31, 2012:

	2012			2011	2010	2009	2008
(Amounts in thousands)	Non-covered	Covered	Total	Non-covered	Non-covered	Non-covered	Non-covered
Commercial loans							
Construction, development, and other land	$ 49,460	$ 34,569	$ 84,029	$ 61,768	$ 83,812	$ 102,867	$ 107,525
Commercial and industrial	88,714	6,972	95,686	91,939	94,123	95,115	83,632
Multi-family residential	65,694	2,611	68,305	77,050	67,824		