

FIRST COMMUNITY BANCSHARES INC /NV/  
Form 10-Q  
November 04, 2016

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

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended September 30, 2016**  
**Commission file number 000-19297**

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

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

**of incorporation)**

**P.O. Box 989**

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

**Identification No.)**

**24605-0989**

**Bluefield, Virginia**  
**(Address of principal executive offices)**

**(Zip Code)**  
**(276) 326-9000**

**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every

Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

Class Common Stock, \$1.00 Par Value; 16,989,383 shares outstanding as of October 28, 2016

FIRST COMMUNITY BANCSHARES, INC.

FORM 10-Q

For the quarter ended September 30, 2016

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****FIRST COMMUNITY BANCSHARES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

|                                                                | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|----------------------------------------------------------------|-------------------------------|------------------------------|
|                                                                | (Unaudited)                   |                              |
| <i>(Amounts in thousands, except share and per share data)</i> |                               |                              |
| <b>Assets</b>                                                  |                               |                              |
| Cash and due from banks                                        | \$ 43,686                     | \$ 37,383                    |
| Federal funds sold                                             | 21,298                        | 13,498                       |
| Interest-bearing deposits in banks                             | 945                           | 906                          |
| Total cash and cash equivalents                                | 65,929                        | 51,787                       |
| Securities available for sale                                  | 220,856                       | 366,173                      |
| Securities held to maturity                                    | 72,182                        | 72,541                       |
| Loans held for investment, net of unearned income              |                               |                              |
| Non-covered                                                    | 1,774,547                     | 1,623,506                    |
| Covered                                                        | 61,837                        | 83,035                       |
| Less allowance for loan losses                                 | (19,633)                      | (20,233)                     |
| Loans held for investment, net                                 | 1,816,751                     | 1,686,308                    |
| FDIC indemnification asset                                     | 14,332                        | 20,844                       |
| Premises and equipment, net                                    | 50,564                        | 52,756                       |
| Other real estate owned, non-covered                           | 4,052                         | 4,873                        |
| Other real estate owned, covered                               | 2,437                         | 4,034                        |
| Interest receivable                                            | 5,498                         | 6,007                        |
| Goodwill                                                       | 101,776                       | 100,486                      |
| Other intangible assets                                        | 7,964                         | 5,243                        |
| Other assets                                                   | 87,932                        | 91,224                       |
| Total assets                                                   | \$ 2,450,273                  | \$ 2,462,276                 |
| <b>Liabilities</b>                                             |                               |                              |
| <b>Deposits</b>                                                |                               |                              |
| Noninterest-bearing                                            | \$ 473,509                    | \$ 451,511                   |
| Interest-bearing                                               | 1,388,390                     | 1,421,748                    |
| Total deposits                                                 | 1,861,899                     | 1,873,259                    |
| Interest, taxes, and other liabilities                         | 26,599                        | 26,630                       |
| Securities sold under agreements to repurchase                 | 118,532                       | 138,614                      |
| FHLB borrowings                                                | 90,000                        | 65,000                       |
| Other borrowings                                               | 15,707                        | 15,756                       |

|                                                                                                                                                                                                                                          |                  |                  |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Total liabilities                                                                                                                                                                                                                        | 2,112,737        | 2,119,259        |
| <b>Stockholders' equity</b>                                                                                                                                                                                                              |                  |                  |
| Preferred stock, undesignated par value; 1,000,000 shares authorized; Series A Noncumulative Convertible Preferred Stock, \$0.01 par value; 25,000 shares authorized; no shares outstanding at September 30, 2016, and December 31, 2015 |                  |                  |
| Common stock, \$1 par value; 50,000,000 shares authorized; 21,381,779 shares issued at September 30, 2016, and December 31, 2015; 4,392,807 and 3,283,638 shares in treasury at September 30, 2016, and December 31, 2015, respectively  | 21,382           | 21,382           |
| Additional paid-in capital                                                                                                                                                                                                               | 227,884          | 227,692          |
| Retained earnings                                                                                                                                                                                                                        | 166,689          | 155,647          |
| Treasury stock, at cost                                                                                                                                                                                                                  | (78,789)         | (56,457)         |
| Accumulated other comprehensive income (loss)                                                                                                                                                                                            | 370              | (5,247)          |
| <b>Total stockholders' equity</b>                                                                                                                                                                                                        | <b>337,536</b>   | <b>343,017</b>   |
| <br>Total liabilities and stockholders' equity                                                                                                                                                                                           | <br>\$ 2,450,273 | <br>\$ 2,462,276 |

*See Notes to Consolidated Financial Statements.*

## FIRST COMMUNITY BANCSHARES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

|                                                                          | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--------------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| (Amounts in thousands, except share and per share data)                  | 2016                                | 2015      | 2016                               | 2015      |
| <b>Interest income</b>                                                   |                                     |           |                                    |           |
| Interest and fees on loans                                               | \$ 21,952                           | \$ 22,259 | \$ 65,762                          | \$ 65,999 |
| Interest on securities taxable                                           | 738                                 | 1,062     | 2,729                              | 3,167     |
| Interest on securities tax-exempt                                        | 905                                 | 994       | 2,762                              | 3,013     |
| Interest on deposits in banks                                            | 26                                  | 33        | 55                                 | 246       |
| Total interest income                                                    | 23,621                              | 24,348    | 71,308                             | 72,425    |
| <b>Interest expense</b>                                                  |                                     |           |                                    |           |
| Interest on deposits                                                     | 1,133                               | 1,384     | 3,334                              | 4,676     |
| Interest on short-term borrowings                                        | 548                                 | 497       | 1,613                              | 1,486     |
| Interest on long-term debt                                               | 819                                 | 798       | 2,438                              | 2,685     |
| Total interest expense                                                   | 2,500                               | 2,679     | 7,385                              | 8,847     |
| <b>Net interest income</b>                                               | 21,121                              | 21,669    | 63,923                             | 63,578    |
| (Recovery of) provision for loan losses                                  | (1,154)                             | 381       | 755                                | 1,757     |
| <b>Net interest income after (recovery of) provision for loan losses</b> | 22,275                              | 21,288    | 63,168                             | 61,821    |
| <b>Noninterest income</b>                                                |                                     |           |                                    |           |
| Wealth management                                                        | 653                                 | 790       | 2,147                              | 2,231     |
| Service charges on deposits                                              | 3,494                               | 3,744     | 10,146                             | 10,154    |
| Other service charges and fees                                           | 2,024                               | 1,974     | 6,088                              | 5,987     |
| Insurance commissions                                                    | 1,592                               | 1,650     | 5,383                              | 5,336     |
| Impairment losses on securities                                          | (4,635)                             |           | (4,646)                            |           |
| Portion of loss recognized in other comprehensive income                 |                                     |           |                                    |           |
| Net impairment losses recognized in earnings                             | (4,635)                             |           | (4,646)                            |           |
| Net gain (loss) on sale of securities                                    | 25                                  | (39)      | (53)                               | 151       |
| Net FDIC indemnification asset amortization                              | (1,369)                             | (1,768)   | (3,856)                            | (5,179)   |
| Net gain on divestitures                                                 | 3,065                               |           | 3,065                              |           |
| Other operating income                                                   | 1,046                               | 723       | 2,554                              | 3,367     |
| Total noninterest income                                                 | 5,895                               | 7,074     | 20,828                             | 22,047    |
| <b>Noninterest expense</b>                                               |                                     |           |                                    |           |
| Salaries and employee benefits                                           | 9,828                               | 9,971     | 30,501                             | 29,357    |
| Occupancy expense                                                        | 1,249                               | 1,443     | 4,139                              | 4,404     |
| Furniture and equipment expense                                          | 1,066                               | 1,259     | 3,271                              | 3,854     |
| Amortization of intangibles                                              | 316                                 | 281       | 871                                | 837       |
| FDIC premiums and assessments                                            | 363                                 | 377       | 1,109                              | 1,181     |
| FHLB debt prepayment fees                                                |                                     |           |                                    | 1,702     |

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|                                                    |                 |                 |                  |                  |
|----------------------------------------------------|-----------------|-----------------|------------------|------------------|
| Merger, acquisition, and divestiture expense       | 226             |                 | 675              | 86               |
| Other operating expense                            | 5,509           | 5,688           | 15,527           | 15,667           |
| <b>Total noninterest expense</b>                   | <b>18,557</b>   | <b>19,019</b>   | <b>56,093</b>    | <b>57,088</b>    |
| Income before income taxes                         | 9,613           | 9,343           | 27,903           | 26,780           |
| Income tax expense                                 | 3,230           | 3,084           | 9,181            | 8,388            |
| <b>Net income</b>                                  | <b>6,383</b>    | <b>6,259</b>    | <b>18,722</b>    | <b>18,392</b>    |
| Dividends on preferred stock                       |                 |                 |                  | 105              |
| <b>Net income available to common shareholders</b> | <b>\$ 6,383</b> | <b>\$ 6,259</b> | <b>\$ 18,722</b> | <b>\$ 18,287</b> |
| <b>Earnings per common share</b>                   |                 |                 |                  |                  |
| Basic                                              | \$ 0.37         | \$ 0.34         | \$ 1.07          | \$ 0.98          |
| Diluted                                            | 0.37            | 0.34            | 1.07             | 0.97             |
| Cash dividends per common share                    | 0.16            | 0.14            | 0.44             | 0.40             |
| <b>Weighted average shares outstanding</b>         |                 |                 |                  |                  |
| Basic                                              | 17,031,074      | 18,470,348      | 17,433,406       | 18,644,679       |
| Diluted                                            | 17,083,526      | 18,500,975      | 17,475,211       | 18,895,909       |

*See Notes to Consolidated Financial Statements.*

**FIRST COMMUNITY BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

|                                                                                                                       | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months<br/>Ended<br/>September 30,</b> |             |
|-----------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-------------|------------------------------------------------|-------------|
| <i>(Amounts in thousands)</i>                                                                                         | <b>2016</b>                                 | <b>2015</b> | <b>2016</b>                                    | <b>2015</b> |
| <b>Net income</b>                                                                                                     | \$ 6,383                                    | \$ 6,259    | \$ 18,722                                      | \$ 18,392   |
| <b>Other comprehensive income, before tax</b>                                                                         |                                             |             |                                                |             |
| Available-for-sale securities:                                                                                        |                                             |             |                                                |             |
| Change in net unrealized gains on securities without<br>other-than-temporary impairment                               | 744                                         | 3,816       | 4,141                                          | 2,993       |
| Reclassification adjustment for net (gains) losses recognized in net<br>income                                        | (25)                                        | 39          | 53                                             | (151)       |
| Reclassification adjustment for other-than-temporary impairment<br>losses recognized in net income                    | 4,635                                       |             | 4,646                                          |             |
| Net unrealized gains on available-for-sale securities                                                                 | 5,354                                       | 3,855       | 8,840                                          | 2,842       |
| Employee benefit plans:                                                                                               |                                             |             |                                                |             |
| Net actuarial loss                                                                                                    | (2)                                         | (1)         | (56)                                           | (98)        |
| Reclassification adjustment for amortization of prior service cost<br>and net actuarial loss recognized in net income | 69                                          | 82          | 205                                            | 245         |
| Net unrealized gains on employee benefit plans                                                                        | 67                                          | 81          | 149                                            | 147         |
| <b>Other comprehensive income, before tax</b>                                                                         | 5,421                                       | 3,936       | 8,989                                          | 2,989       |
| Income tax expense                                                                                                    | (2,034)                                     | (1,476)     | (3,372)                                        | (1,122)     |
| <b>Other comprehensive income, net of tax</b>                                                                         | 3,387                                       | 2,460       | 5,617                                          | 1,867       |
| <b>Total comprehensive income</b>                                                                                     | \$ 9,770                                    | \$ 8,719    | \$ 24,339                                      | \$ 20,259   |

*See Notes to Consolidated Financial Statements.*



## FIRST COMMUNITY BANCSHARES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(UNAUDITED)

| <i>(Amounts in thousands, except share and per share data)</i>    | Preferred Stock | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total      |
|-------------------------------------------------------------------|-----------------|--------------|----------------------------|-------------------|----------------|-----------------------------------------------|------------|
| Balance January 1, 2015                                           | \$ 15,151       | \$ 20,500    | \$ 215,873                 | \$ 141,206        | \$ (35,751)    | \$ (5,605)                                    | \$ 351,374 |
| Net income                                                        |                 |              |                            | 18,392            |                |                                               | 18,392     |
| Other comprehensive income                                        |                 |              |                            |                   |                | 1,867                                         | 1,867      |
| Common dividends declared \$0.40 per share                        |                 |              |                            | (7,447)           |                |                                               | (7,447)    |
| Preferred dividends declared \$15.00 per share                    |                 |              |                            | (105)             |                |                                               | (105)      |
| Preferred stock converted to common stock 882,096 shares          | (12,784)        | 882          | 11,902                     |                   |                |                                               |            |
| Redemption of preferred stock 2,367 shares                        | (2,367)         |              |                            |                   |                |                                               | (2,367)    |
| Equity-based compensation expense                                 |                 |              | 43                         |                   |                |                                               | 43         |
| Common stock options exercised 3,000 shares                       |                 |              | (10)                       |                   | 51             |                                               | 41         |
| Restricted stock awards 22,561 shares                             |                 |              | (192)                      |                   | 383            |                                               | 191        |
| Issuance of treasury stock to 401(k) plan 18,275 shares           |                 |              | 5                          |                   | 311            |                                               | 316        |
| Purchase of treasury shares 1,018,726 shares at \$17.13 per share |                 |              |                            |                   | (17,478)       |                                               | (17,478)   |
| Balance September 30, 2015                                        | \$              | \$ 21,382    | \$ 227,621                 | \$ 152,046        | \$ (52,484)    | \$ (3,738)                                    | \$ 344,827 |
| Balance January 1, 2016                                           | \$              | \$ 21,382    | \$ 227,692                 | \$ 155,647        | \$ (56,457)    | \$ (5,247)                                    | \$ 343,017 |
| Net income                                                        |                 |              |                            | 18,722            |                |                                               | 18,722     |
| Other comprehensive income                                        |                 |              |                            |                   |                | 5,617                                         | 5,617      |
| Common dividends declared \$0.44 per share                        |                 |              |                            | (7,680)           |                |                                               | (7,680)    |
| Equity-based compensation expense                                 |                 |              | 144                        |                   |                |                                               | 144        |
| Common stock options exercised 11,730 shares                      |                 |              | (23)                       |                   | 205            |                                               | 182        |
| Restricted stock awards 15,587 shares                             |                 |              | 26                         |                   | 270            |                                               | 296        |
| Issuance of treasury stock to 401(k) plan 16,290 shares           |                 |              | 45                         |                   | 287            |                                               | 332        |

Purchase of treasury shares

1,152,776 shares at \$20.00 per  
share

(23,094)

(23,094)

|                            |    |           |            |            |             |    |     |            |
|----------------------------|----|-----------|------------|------------|-------------|----|-----|------------|
| Balance September 30, 2016 | \$ | \$ 21,382 | \$ 227,884 | \$ 166,689 | \$ (78,789) | \$ | 370 | \$ 337,536 |
|----------------------------|----|-----------|------------|------------|-------------|----|-----|------------|

*See Notes to Consolidated Financial Statements.*

## FIRST COMMUNITY BANCSHARES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

|                                                                                   | Nine Months Ended<br>September 30, |           |
|-----------------------------------------------------------------------------------|------------------------------------|-----------|
| (Amounts in thousands)                                                            | 2016                               | 2015      |
| <b>Operating activities</b>                                                       |                                    |           |
| Net income                                                                        | \$ 18,722                          | \$ 18,392 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |           |
| Provision for loan losses                                                         | 755                                | 1,757     |
| Depreciation and amortization of property, plant, and equipment                   | 2,707                              | 3,143     |
| Amortization of premiums on investments, net                                      | 2,758                              | 5,872     |
| Amortization of FDIC indemnification asset, net                                   | 3,856                              | 5,179     |
| Amortization of intangible assets                                                 | 871                                | 837       |
| Accretion on acquired loans                                                       | (3,893)                            | (5,439)   |
| Gain on divestiture, net                                                          | (3,065)                            |           |
| Gain on sale of loans, net                                                        |                                    | (439)     |
| Equity-based compensation expense                                                 | 144                                | 43        |
| Restricted stock awards                                                           | 296                                | 191       |
| Issuance of treasury stock to 401(k) plan                                         | 332                                | 316       |
| Loss on sale of property, plant, and equipment, net                               | 271                                | 26        |
| Loss on sale of other real estate                                                 | 1,487                              | 2,538     |
| Loss (gain) on sale of securities                                                 | 53                                 | (151)     |
| Net impairment losses recognized in earnings                                      | 4,646                              |           |
| FHLB debt prepayment fees                                                         |                                    | 1,702     |
| Proceeds from sale of mortgage loans                                              |                                    | 18,531    |
| Originations of mortgage loans                                                    |                                    | (16,823)  |
| Decrease in accrued interest receivable                                           | 509                                | 405       |
| Decrease in other operating activities                                            | 4,341                              | 12,701    |
| Net cash provided by operating activities                                         | 34,790                             | 48,781    |
| <b>Investing activities</b>                                                       |                                    |           |
| Proceeds from sale of securities available for sale                               | 70,530                             | 266       |
| Proceeds from maturities, prepayments, and calls of securities available for sale | 77,395                             | 22,350    |
| Proceeds from maturities and calls of securities held to maturity                 | 190                                | 190       |
| Payments to acquire securities available for sale                                 | (1,174)                            | (81,540)  |
| Payments to acquire securities held to maturity                                   |                                    | (15,003)  |
| Originations of loans, net                                                        | (138,984)                          | (6,994)   |
| (Payments for) proceeds from FHLB stock, net                                      | (933)                              | 1,279     |
| Cash proceeds from (paid in) mergers, acquisitions, and divestitures, net         | 24,816                             | (88)      |
| Proceeds from the FDIC                                                            | 3,639                              | 2,411     |
| Payments to acquire property, plant, and equipment, net                           | (448)                              | (919)     |
| Proceeds from sale of other real estate                                           | 4,541                              | 5,365     |
| Net cash provided by (used in) investing activities                               | 39,572                             | (72,683)  |
| <b>Financing activities</b>                                                       |                                    |           |
| Increase in noninterest-bearing deposits, net                                     | 28,322                             | 24,292    |

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|                                                                                   |           |           |
|-----------------------------------------------------------------------------------|-----------|-----------|
| Decrease in interest-bearing deposits, net                                        | (62,819)  | (122,149) |
| (Repayments of) proceeds from securities sold under agreements to repurchase, net | (20,082)  | 2,334     |
| Proceeds from (repayments of) FHLB and other borrowings, net                      | 24,951    | (28,746)  |
| Redemption of preferred stock                                                     |           | (2,367)   |
| Proceeds from stock options exercised                                             | 182       | 41        |
| Excess tax benefit from equity-based compensation                                 |           | 5         |
| Payments for repurchase of treasury stock                                         | (23,094)  | (17,478)  |
| Payments of common dividends                                                      | (7,680)   | (7,447)   |
| Payments of preferred dividends                                                   |           | (219)     |
| Net cash used in financing activities                                             | (60,220)  | (151,734) |
| Net increase (decrease) in cash and cash equivalents                              | 14,142    | (175,636) |
| Cash and cash equivalents at beginning of period                                  | 51,787    | 237,660   |
| Cash and cash equivalents at end of period                                        | \$ 65,929 | \$ 62,024 |
| <b>Supplemental transactions noncash items</b>                                    |           |           |
| Transfer of loans to other real estate                                            | \$ 3,652  | \$ 4,139  |
| Loans originated to finance other real estate                                     | 42        | 37        |
| <b>Supplemental disclosure cash flow information</b>                              |           |           |
| Cash paid for interest                                                            | 7,394     | 9,167     |
| Cash paid for income taxes                                                        | 6,488     | 6,900     |
| <i>See Notes to Consolidated Financial Statements.</i>                            |           |           |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### Note 1. Basis of Presentation

#### *General*

First Community Bancshares, Inc. (the *Company*) is a financial holding company headquartered in Bluefield, Virginia that provides banking products and services to individuals and commercial customers through its wholly-owned subsidiary, First Community Bank (the *Bank*), a Virginia-chartered banking institution. The Bank operates 45 branches in 4 states as First Community Bank in Virginia, West Virginia, and North Carolina and under the trade name People's Community Bank, a Division of First Community Bank, in Tennessee. The Bank offers personal and commercial insurance products and services from certain branch locations through First Community Insurance Services (FCIS) in Virginia and West Virginia. The Bank offers wealth management services and investment advice through its Trust Division and wholly-owned subsidiary First Community Wealth Management (FCWM). The Trust Division and FCWM managed \$767 million in combined assets as of September 30, 2016. These assets are not assets of the Company, but are managed under various fee-based arrangements as fiduciary or agent. The Company reported consolidated assets of \$2.45 billion as of September 30, 2016. The Company operates in one business segment, Community Banking, which consists of all operations, including commercial and consumer banking, lending activities, wealth management, and insurance services. Unless the context suggests otherwise, the term *Company* refers to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity.

The Company prepared the accompanying unaudited condensed consolidated financial statements in accordance with generally accepted accounting principles (GAAP) in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The Company eliminated all significant intercompany balances and transactions in consolidation and, in management's option, made all adjustments, including normal recurring accruals, necessary for a fair presentation. Assets held in an agency or fiduciary capacity are not assets of the Company and are not included in the Company's consolidated balance sheets. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full calendar year.

The condensed consolidated balance sheet as of December 31, 2015, has been derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K (the 2015 Form 10-K), as filed with the Securities and Exchange Commission (the SEC) on March 4, 2016. Certain information and footnote disclosures normally included in annual consolidated financial statements were omitted in accordance with standards for the preparation of interim consolidated financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's 2015 Form 10-K.

#### *Significant Accounting Policies*

A complete and detailed description of the Company's significant accounting policies is included in Note 1, Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's 2015 Form 10-K. A discussion of the Company's application of critical accounting estimates is included in Critical Accounting Estimates in Item 2 of this report.

#### *Recent Accounting Pronouncements*

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The update will make eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 will be effective for fiscal years and interim periods within those fiscal years

beginning after December 15, 2017, with early adoption permitted. The update should be applied on a retrospective basis unless it is impracticable to apply, in which case the update would be applied prospectively as of the earliest date practicable. The Company is currently evaluating the impact that ASU 2016-15 will have on its financial position, results of operations, and cash flows.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new guidance is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The new guidance requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective on January 1, 2020. The Company is currently evaluating the impact that ASU 2016-13 will have on its financial position, results of operations, and cash flows.

In March 2016, the FASB issued ASU 2016-09, Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The new guidance is intended to simplify several aspects of the accounting for share-based payment award transactions including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact that ASU 2016-09 will have on its financial position, results of operations, and cash flows and does not expect this guidance to have a material effect on its financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The new guidance is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requiring more disclosures related to leasing transactions. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact that ASU 2016-02 will have on its financial position, results of operations, and cash flows and does not expect this guidance to have a material effect on its financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The update amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. Although the new guidance retains many current requirements, it significantly revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. The new guidance also amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 will be effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017, with early adoption permitted for certain changes. The Company is currently evaluating the impact that ASU 2016-01 will have on its financial position, results of operations, and cash flows.

The Company does not expect other recent accounting standards issued by the FASB or other standards-setting bodies to have a material impact on the consolidated financial statements.

### ***Reclassifications and Corrections***

Certain amounts reported in prior years have been reclassified to conform to the current year's presentation. These reclassifications had no effect on the Company's results of operations, financial position, or cash flow.

## **Note 2. Acquisitions and Divestitures**

### ***First Bank***

On July 15, 2016, the Company completed the previously announced branch exchange with First Bank, North Carolina, pursuant to which the Bank exchanged a portion of its North Carolina branch network for First Bank's Virginia branch network. Under the agreements, the Bank simultaneously sold six branches in the Winston-Salem and Mooresville areas of North Carolina and acquired seven branches in Southwestern Virginia. The branch acquisition complements the Company's 2014 acquisition of seven branches from Bank of America by expanding the Company's existing presence in Southwest Virginia and affords the opportunity to realize certain operating cost savings. The Company incurred expenses related to the First Bank transaction of \$226 thousand for the three months ended September 30, 2016, and \$675 thousand for the nine months ended September 30, 2016. The estimated fair values, including identifiable intangible assets, are preliminary and subject to refinement for up to one year after the closing date of the acquisition. See Acquisition and Divestiture below for additional transaction details.

### ***Acquisition***

On July 15, 2016, the Company completed the acquisition of seven branches in Southwestern Virginia from First Bank. The consideration transferred included the net fair value of certain assets and liabilities divested, see Divestiture below, plus a premium paid of \$3.84 million. The Company did not acquire any purchased credit-impaired loans as a result of the branch acquisition.

The following table summarizes the fair value of assets purchased and liabilities assumed:

*(Amounts in thousands)*

|                                      |                |
|--------------------------------------|----------------|
| <b>Assets</b>                        |                |
| Loans receivable                     | \$ 149,122     |
| Premises and equipment               | 4,829          |
| Goodwill and other intangible assets | 6,288          |
| Other assets                         | 448            |
| <br>Total assets purchased           | <br>\$ 160,687 |
| <br><b>Liabilities</b>               |                |
| Deposits                             | \$ 134,307     |
| Other liabilities                    | 75             |
| <br>Total liabilities assumed        | <br>\$ 134,382 |

*Divestiture*

On July 15, 2016, the Company completed the exchange of six branches in the Winston-Salem and Mooresville areas of North Carolina to First Bank. At closing, the Company divested certain assets and liabilities at fair value and received a premium of \$4.07 million. The Company recorded a net gain of \$3.07 million in connection with the divestiture and reversed \$1.35 million in the allowance for loan losses related to divested loans. The Company received \$24.82 million in cash in connection with the First Bank transaction.

The following table summarizes the fair value of assets and liabilities divested:

*(Amounts in thousands)*

|                                      |                |
|--------------------------------------|----------------|
| <b>Assets</b>                        |                |
| Loans receivable                     | \$ 155,538     |
| Premises and equipment               | 3,861          |
| Goodwill and other intangible assets | 2,326          |
| Other assets                         | 443            |
| <br>Total assets divested            | <br>\$ 162,168 |
| <br><b>Liabilities</b>               |                |
| Deposits                             | \$ 111,019     |
| Other liabilities                    | 28             |
| <br>Total liabilities divested       | <br>\$ 111,047 |



**Note 3. Investment Securities**

The following tables present the amortized cost and aggregate fair value of available-for-sale securities, including gross unrealized gains and losses, as of the dates indicated:

| <i>(Amounts in thousands)</i>              | <b>September 30, 2016</b> |                         |                          |                   |
|--------------------------------------------|---------------------------|-------------------------|--------------------------|-------------------|
|                                            | <b>Amortized Cost</b>     | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> |
| U.S. Agency securities                     | \$ 1,371                  | \$ 4                    | \$                       | \$ 1,375          |
| Municipal securities                       | 116,910                   | 5,171                   | (7)                      | 122,074           |
| Single issue trust preferred securities    | 51,292                    |                         | (2,772)                  | 48,520            |
| Corporate securities                       | 15,027                    |                         | (5)                      | 15,022            |
| Mortgage-backed Agency securities          | 33,578                    | 294                     | (80)                     | 33,792            |
| Equity securities                          | 55                        | 18                      |                          | 73                |
| <b>Total securities available for sale</b> | <b>\$ 218,233</b>         | <b>\$ 5,487</b>         | <b>\$ (2,864)</b>        | <b>\$ 220,856</b> |

| <i>(Amounts in thousands)</i>              | <b>December 31, 2015</b> |                         |                          |                   |
|--------------------------------------------|--------------------------|-------------------------|--------------------------|-------------------|
|                                            | <b>Amortized Cost</b>    | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> |
| U.S. Agency securities                     | \$ 31,414                | \$ 39                   | \$ (751)                 | \$ 30,702         |
| Municipal securities                       | 124,880                  | 4,155                   | (357)                    | 128,678           |
| Single issue trust preferred securities    | 55,882                   |                         | (8,050)                  | 47,832            |
| Corporate securities                       | 70,571                   |                         | (238)                    | 70,333            |
| Certificates of deposit                    | 5,000                    |                         |                          | 5,000             |
| Mortgage-backed Agency securities          | 84,576                   | 155                     | (1,175)                  | 83,556            |
| Equity securities                          | 66                       | 6                       |                          | 72                |
| <b>Total securities available for sale</b> | <b>\$ 372,389</b>        | <b>\$ 4,355</b>         | <b>\$ (10,571)</b>       | <b>\$ 366,173</b> |

The following tables present the amortized cost and aggregate fair value of held-to-maturity securities, including gross unrealized gains and losses, as of the dates indicated:

| <i>(Amounts in thousands)</i>            | <b>September 30, 2016</b> |                         |                          |                   |
|------------------------------------------|---------------------------|-------------------------|--------------------------|-------------------|
|                                          | <b>Amortized Cost</b>     | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> |
| U.S. Agency securities                   | \$ 61,766                 | \$ 317                  | \$                       | \$ 62,083         |
| Corporate securities                     | 10,416                    | 108                     |                          | 10,524            |
| <b>Total securities held to maturity</b> | <b>\$ 72,182</b>          | <b>\$ 425</b>           | <b>\$</b>                | <b>\$ 72,607</b>  |

| <i>(Amounts in thousands)</i> | <b>December 31, 2015</b> |                         |                          |                   |
|-------------------------------|--------------------------|-------------------------|--------------------------|-------------------|
|                               | <b>Amortized Cost</b>    | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> |

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|                                   |           |       |          |           |
|-----------------------------------|-----------|-------|----------|-----------|
| U.S. Agency securities            | \$ 61,863 | \$ 75 | \$ (106) | \$ 61,832 |
| Municipal securities              | 190       | 3     |          | 193       |
| Corporate securities              | 10,488    |       | (23)     | 10,465    |
| Total securities held to maturity | \$ 72,541 | \$ 78 | \$ (129) | \$ 72,490 |

The following table presents the amortized cost and aggregate fair value of available-for-sale securities and held-to-maturity securities, by contractual maturity, as of the date indicated. Actual maturities could differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

| <i>(Amounts in thousands)</i>              | <b>September 30, 2016</b> |                   |
|--------------------------------------------|---------------------------|-------------------|
|                                            | <b>Amortized Cost</b>     | <b>Fair Value</b> |
| <b>Available-for-sale securities</b>       |                           |                   |
| Due within one year                        | \$ 16,747                 | \$ 16,753         |
| Due after one year but within five years   | 2,131                     | 2,178             |
| Due after five years but within ten years  | 87,281                    | 91,586            |
| Due after ten years                        | 78,441                    | 76,474            |
|                                            | 184,600                   | 186,991           |
| Mortgage-backed securities                 | 33,578                    | 33,792            |
| Equity securities                          | 55                        | 73                |
| <b>Total securities available for sale</b> | <b>\$ 218,233</b>         | <b>\$ 220,856</b> |
| <b>Held-to-maturity securities</b>         |                           |                   |
| Due within one year                        | \$ 46,867                 | \$ 46,909         |
| Due after one year but within five years   | 25,315                    | 25,698            |
| Due after five years but within ten years  |                           |                   |
| Due after ten years                        |                           |                   |
| <b>Total securities held to maturity</b>   | <b>\$ 72,182</b>          | <b>\$ 72,607</b>  |

The following tables present the fair values and unrealized losses for available-for-sale securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of the dates indicated:

| <i>(Amounts in thousands)</i>           | <b>September 30, 2016</b>  |                          |                            |                          |                   |                          |
|-----------------------------------------|----------------------------|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
|                                         | <b>Less than 12 Months</b> |                          | <b>12 Months or Longer</b> |                          | <b>Total</b>      |                          |
|                                         | <b>Fair Value</b>          | <b>Unrealized Losses</b> | <b>Fair Value</b>          | <b>Unrealized Losses</b> | <b>Fair Value</b> | <b>Unrealized Losses</b> |
| U.S. Agency securities                  | \$                         | \$                       | \$                         | \$                       | \$                | \$                       |
| Municipal securities                    |                            |                          | 767                        | (7)                      | 767               | (7)                      |
| Single issue trust preferred securities |                            |                          | 19,323                     | (2,772)                  | 19,323            | (2,772)                  |
| Corporate securities                    |                            |                          | 15,022                     | (5)                      | 15,022            | (5)                      |
| Mortgage-backed Agency securities       | 1,167                      | (1)                      | 13,589                     | (79)                     | 14,756            | (80)                     |
| <b>Total</b>                            | <b>\$ 1,167</b>            | <b>\$ (1)</b>            | <b>\$ 48,701</b>           | <b>\$ (2,863)</b>        | <b>\$ 49,868</b>  | <b>\$ (2,864)</b>        |

**December 31, 2015**

|                                         | Less than 12<br>Months |                      | 12 Months or Longer |                      | Total         |                      |
|-----------------------------------------|------------------------|----------------------|---------------------|----------------------|---------------|----------------------|
|                                         | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| <i>(Amounts in thousands)</i>           |                        |                      |                     |                      |               |                      |
| U.S. Agency securities                  | \$ 4,441               | \$ (5)               | \$ 23,922           | \$ (746)             | \$ 28,363     | \$ (751)             |
| Municipal securities                    | 8,126                  | (48)                 | 10,393              | (309)                | 18,519        | (357)                |
| Single issue trust preferred securities |                        |                      | 47,832              | (8,050)              | 47,832        | (8,050)              |
| Corporate securities                    | 70,333                 | (238)                |                     |                      | 70,333        | (238)                |
| Mortgage-backed Agency securities       | 27,050                 | (253)                | 37,291              | (922)                | 64,341        | (1,175)              |
| Total                                   | \$ 109,950             | \$ (544)             | \$ 119,438          | \$ (10,027)          | \$ 229,388    | \$ (10,571)          |

There were no unrealized losses on held-to-maturity securities as of September 30, 2016. The following table presents the fair values and unrealized losses for held-to-maturity securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of December 31, 2015.

|                               | December 31, 2015   |                   |                     |                   |                  |                   |
|-------------------------------|---------------------|-------------------|---------------------|-------------------|------------------|-------------------|
|                               | Less than 12 Months |                   | 12 Months or Longer |                   | Total            |                   |
|                               | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value       | Unrealized Losses |
| <i>(Amounts in thousands)</i> |                     |                   |                     |                   |                  |                   |
| U.S. Agency securities        | \$ 43,723           | \$ (106)          | \$                  | \$                | \$ 43,723        | \$ (106)          |
| Corporate securities          | 6,851               | (23)              |                     |                   | 6,851            | (23)              |
| <b>Total</b>                  | <b>\$ 50,574</b>    | <b>\$ (129)</b>   | <b>\$</b>           | <b>\$</b>         | <b>\$ 50,574</b> | <b>\$ (129)</b>   |

There were 20 individual securities in an unrealized loss position as of September 30, 2016, and their combined depreciation in value represented 0.98% of the investment securities portfolio. There were 107 individual securities in an unrealized loss position as of December 31, 2015, and their combined depreciation in value represented 2.44% of the investment securities portfolio.

The following table presents gross realized gains and losses from the sale of available-for-sale securities for the periods indicated:

|                                              | Three Months Ended |                    | Nine Months Ended  |                    |
|----------------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                              | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| <i>(Amounts in thousands)</i>                |                    |                    |                    |                    |
| Gross realized gains                         | \$ 203             | \$ 26              | \$ 344             | \$ 292             |
| Gross realized losses                        | (178)              | (65)               | (397)              | (141)              |
| <b>Net gain (loss) on sale of securities</b> | <b>\$ 25</b>       | <b>\$ (39)</b>     | <b>\$ (53)</b>     | <b>\$ 151</b>      |

The carrying amount of securities pledged for various purposes totaled \$151.82 million as of September 30, 2016, and \$236.73 million as of December 31, 2015.

The Company reviews its investment portfolio quarterly for indications of other-than-temporary impairment ( OTTI ). Debt securities owned by the Company include securities issued from the U.S. Department of the Treasury ( Treasury ), municipal securities, single issue trust preferred securities, corporate securities, and certificates of deposit. For debt securities owned, the Company analyzes factors such as the impairment s severity and duration, adverse conditions within the issuing industry, prospects for the issuer, ability to hold until recovery, security performance, changes in rating by rating agencies, and other qualitative factors to determine if the impairment will be recovered. If the evaluation suggests that the impairment will not be recovered, OTTI is recorded as a charge to earnings through noninterest income. Temporary impairment on these securities is primarily due to changes in benchmark interest rates, changes in pricing in the credit markets, destabilization in foreign markets, and other current economic factors. During the three and nine months ended September 30, 2016, the Company incurred OTTI charges on debt securities owned of \$4.64 million related to the Company s change in intent to hold certain securities to recovery. The intent was changed to sell specific trust preferred securities in the Company s investment portfolio primarily to reduce credit concentrations with two issuers. During the three and nine months ended September 30, 2015, the Company incurred

no OTTI charges on debt securities owned.

For equity securities, the Company considers its intent to hold or sell the security before recovery, 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 related to issuer, general market, or industry conditions to determine if the impairment will be recovered. If the Company deems the impairment other-than-temporary in nature, the security is written down to its current present value and the OTTI loss is charged to earnings. During the three months ended September 30, 2016, the Company incurred no OTTI charges related to certain equity holdings. During the nine months ended September 30, 2016, the Company incurred OTTI charges related to certain equity holdings of \$11 thousand. During the three and nine months ended September 30, 2015, the Company incurred no OTTI charges on equity holdings.

**Note 4. Loans**

The Company groups loans held for investment into three segments (commercial loans, consumer real estate loans, and consumer and other loans) with each segment divided into various classes. Covered loans are those loans acquired in Federal Deposit Insurance Corporation ( FDIC ) assisted transactions that are covered by loss share agreements. The following table presents loans, net of unearned income and disaggregated by class, as of the periods indicated:

| <i>(Amounts in thousands)</i>                           | <b>September 30, 2016</b> |                | <b>December 31, 2015</b> |                |
|---------------------------------------------------------|---------------------------|----------------|--------------------------|----------------|
|                                                         | <b>Amount</b>             | <b>Percent</b> | <b>Amount</b>            | <b>Percent</b> |
| Non-covered loans held for investment                   |                           |                |                          |                |
| Commercial loans                                        |                           |                |                          |                |
| Construction, development, and other land               | \$ 49,799                 | 2.71%          | \$ 48,896                | 2.86%          |
| Commercial and industrial                               | 90,362                    | 4.92%          | 88,903                   | 5.21%          |
| Multi-family residential                                | 127,468                   | 6.94%          | 95,026                   | 5.57%          |
| Single family non-owner occupied                        | 144,023                   | 7.84%          | 149,351                  | 8.75%          |
| Non-farm, non-residential                               | 596,015                   | 32.46%         | 485,460                  | 28.45%         |
| Agricultural                                            | 5,786                     | 0.32%          | 2,911                    | 0.17%          |
| Farmland                                                | 31,974                    | 1.74%          | 27,540                   | 1.61%          |
| Total commercial loans                                  | 1,045,427                 | 56.93%         | 898,087                  | 52.62%         |
| Consumer real estate loans                              |                           |                |                          |                |
| Home equity lines                                       | 108,108                   | 5.89%          | 107,367                  | 6.29%          |
| Single family owner occupied                            | 497,695                   | 27.10%         | 495,209                  | 29.02%         |
| Owner occupied construction                             | 43,925                    | 2.39%          | 43,505                   | 2.55%          |
| Total consumer real estate loans                        | 649,728                   | 35.38%         | 646,081                  | 37.86%         |
| Consumer and other loans                                |                           |                |                          |                |
| Consumer loans                                          | 76,363                    | 4.16%          | 72,000                   | 4.22%          |
| Other                                                   | 3,029                     | 0.16%          | 7,338                    | 0.43%          |
| Total consumer and other loans                          | 79,392                    | 4.32%          | 79,338                   | 4.65%          |
| Total non-covered loans                                 | 1,774,547                 | 96.63%         | 1,623,506                | 95.13%         |
| Total covered loans                                     | 61,837                    | 3.37%          | 83,035                   | 4.87%          |
| Total loans held for investment, net of unearned income | \$ 1,836,384              | 100.00%        | \$ 1,706,541             | 100.00%        |

Customer overdrafts reclassified as loans totaled \$1.18 million as of September 30, 2016, and \$1.24 million as of December 31, 2015. Deferred loan fees totaled \$5.29 million as of September 30, 2016, and \$3.78 million as of December 31, 2015. For information concerning off-balance sheet financing, see Note 14, Litigation, Commitments and Contingencies, to the Condensed Consolidated Financial Statements of this report.

The following table presents the covered loan portfolio, disaggregated by class, as of the dates indicated:

| <i>(Amounts in thousands)</i>             | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|-------------------------------------------|---------------------------|--------------------------|
| <b>Commercial loans</b>                   |                           |                          |
| Construction, development, and other land | \$ 4,699                  | \$ 6,303                 |
| Commercial and industrial                 | 941                       | 1,170                    |
| Multi-family residential                  | 43                        | 640                      |
| Single family non-owner occupied          | 1,328                     | 2,674                    |
| Non-farm, non-residential                 | 8,312                     | 14,065                   |
| Agricultural                              | 26                        | 34                       |
| Farmland                                  | 412                       | 643                      |
| <b>Total commercial loans</b>             | <b>15,761</b>             | <b>25,529</b>            |
| <b>Consumer real estate loans</b>         |                           |                          |
| Home equity lines                         | 38,737                    | 48,565                   |
| Single family owner occupied              | 7,058                     | 8,595                    |
| Owner occupied construction               | 201                       | 262                      |
| <b>Total consumer real estate loans</b>   | <b>45,996</b>             | <b>57,422</b>            |
| <b>Consumer and other loans</b>           |                           |                          |
| Consumer loans                            | 80                        | 84                       |
| <b>Total covered loans</b>                | <b>\$ 61,837</b>          | <b>\$ 83,035</b>         |

The Company identifies certain purchased loans as impaired when fair values are established at acquisition and aggregates purchased credit impaired ( PCI ) loans into loan pools with common risk characteristics. The Company estimates cash flows to be collected on PCI loans and discounts those cash flows at a market rate of interest. The following table presents the carrying and contractual unpaid principal balance of PCI loans, by acquisition, as of the dates indicated:

|                               | <b>September 30, 2016</b> |                                 | <b>December 31, 2015</b> |                                 |
|-------------------------------|---------------------------|---------------------------------|--------------------------|---------------------------------|
| <i>(Amounts in thousands)</i> | <b>Carrying Balance</b>   | <b>Unpaid Principal Balance</b> | <b>Carrying Balance</b>  | <b>Unpaid Principal Balance</b> |
| Peoples Bank of Virginia      | \$ 5,798                  | \$ 9,762                        | \$ 6,681                 | \$ 11,249                       |
| Waccamaw Bank                 | 24,877                    | 48,642                          | 34,707                   | 63,151                          |
| Other acquired                | 1,121                     | 1,147                           | 1,254                    | 1,297                           |
| <b>Total PCI Loans</b>        | <b>\$ 31,796</b>          | <b>\$ 59,551</b>                | <b>\$ 42,642</b>         | <b>\$ 75,697</b>                |



The following tables present the activity in the accretable yield on PCI loans, by acquisition, for the periods indicated:

| <i>(Amounts in thousands)</i>                   | <b>Nine Months Ended September 30, 2016</b> |                 |              |
|-------------------------------------------------|---------------------------------------------|-----------------|--------------|
|                                                 | <b>Peoples</b>                              | <b>Waccamaw</b> | <b>Total</b> |
| Beginning balance                               | \$ 3,589                                    | \$ 26,109       | \$ 29,698    |
| Accretion                                       | (982)                                       | (4,408)         | (5,390)      |
| Reclassifications from nonaccretable difference | 231                                         | 848             | 1,079        |
| Removals, extensions, and other events, net     | 1,774                                       | 4               | 1,778        |
| Ending balance                                  | \$ 4,612                                    | \$ 22,553       | \$ 27,165    |

| <i>(Amounts in thousands)</i>                   | <b>Nine Months Ended September 30, 2015</b> |                 |              |
|-------------------------------------------------|---------------------------------------------|-----------------|--------------|
|                                                 | <b>Peoples</b>                              | <b>Waccamaw</b> | <b>Total</b> |
| Beginning balance                               | \$ 4,745                                    | \$ 19,048       | \$ 23,793    |
| Additions                                       |                                             | 2               | 2            |
| Accretion                                       | (1,906)                                     | (5,069)         | (6,975)      |
| Reclassifications from nonaccretable difference | 583                                         | 3,225           | 3,808        |
| Removals, extensions, and other events, net     | (27)                                        | 5,203           | 5,176        |
| Ending balance                                  | \$ 3,395                                    | \$ 22,409       | \$ 25,804    |

## Note 5. Credit Quality

The Company uses a risk grading matrix to assign a risk grade to each loan in its portfolio. Loan risk ratings may be upgraded or downgraded to reflect current information identified during the loan review process. The general characteristics of each risk grade are as follows:

**Pass** This grade is assigned to loans with acceptable credit quality and risk. The Company further segments this grade based on borrower characteristics that include capital strength, earnings stability, liquidity, leverage, and industry conditions.

**Special Mention** This grade is assigned to loans that require an above average degree of supervision and attention. These loans have the characteristics of an asset with acceptable credit quality and risk; however, adverse economic or financial conditions exist that create potential weaknesses deserving of management's close attention. If potential weaknesses are not corrected, the prospect of repayment may worsen.

**Substandard** This grade is assigned to loans that have well defined weaknesses that may make payment default, or principal exposure, possible. These loans will likely be dependent on collateral liquidation, secondary repayment sources, or events outside the normal course of business to meet repayment terms.

**Doubtful** This grade is assigned to loans that have the weaknesses inherent in substandard loans; however, the weaknesses are so severe that collection or liquidation in full is unlikely based on current facts, conditions, and values. Due to certain specific pending factors, the amount of loss cannot yet be determined.

**Loss** This grade is assigned to loans that will be charged off or charged down when payments, including the timing and value of payments, are uncertain. This risk grade does not imply that the asset has no recovery or salvage value, but simply means that it is not practical or desirable to defer writing off, either all or a portion of, the loan balance even though partial recovery may be realized in the future.

The following tables present the recorded investment of the loan portfolio, disaggregated by class and credit quality, as of the dates indicated. Losses on covered loans are generally reimbursable by the FDIC at the applicable loss share percentage, 80%; therefore, covered loans are disclosed separately.

| (Amounts in thousands)                    | September 30, 2016  |                    |                  |                 |             |                     |
|-------------------------------------------|---------------------|--------------------|------------------|-----------------|-------------|---------------------|
|                                           | Pass                | Special<br>Mention | Substandard      | Doubtful        | Loss        | Total               |
| <b>Non-covered loans</b>                  |                     |                    |                  |                 |             |                     |
| Commercial loans                          |                     |                    |                  |                 |             |                     |
| Construction, development, and other land | \$ 48,015           | \$ 992             | \$ 792           | \$              | \$          | \$ 49,799           |
| Commercial and industrial                 | 85,440              | 3,687              | 1,235            |                 |             | 90,362              |
| Multi-family residential                  | 118,153             | 8,528              | 787              |                 |             | 127,468             |
| Single family non-owner occupied          | 133,550             | 4,644              | 5,829            |                 |             | 144,023             |
| Non-farm, non-residential                 | 568,766             | 16,044             | 10,495           | 710             |             | 596,015             |
| Agricultural                              | 5,711               | 75                 |                  |                 |             | 5,786               |
| Farmland                                  | 29,653              | 1,820              | 501              |                 |             | 31,974              |
| Consumer real estate loans                |                     |                    |                  |                 |             |                     |
| Home equity lines                         | 106,086             | 733                | 1,289            |                 |             | 108,108             |
| Single family owner occupied              | 471,389             | 5,725              | 20,102           | 479             |             | 497,695             |
| Owner occupied construction               | 43,216              |                    | 709              |                 |             | 43,925              |
| Consumer and other loans                  |                     |                    |                  |                 |             |                     |
| Consumer loans                            | 76,086              | 23                 | 248              |                 | 6           | 76,363              |
| Other                                     | 3,029               |                    |                  |                 |             | 3,029               |
| <b>Total non-covered loans</b>            | <b>1,689,094</b>    | <b>42,271</b>      | <b>41,987</b>    | <b>1,189</b>    | <b>6</b>    | <b>1,774,547</b>    |
| <b>Covered loans</b>                      |                     |                    |                  |                 |             |                     |
| Commercial loans                          |                     |                    |                  |                 |             |                     |
| Construction, development, and other land | 2,830               | 872                | 997              |                 |             | 4,699               |
| Commercial and industrial                 | 926                 |                    | 15               |                 |             | 941                 |
| Multi-family residential                  |                     |                    | 43               |                 |             | 43                  |
| Single family non-owner occupied          | 1,056               | 65                 | 207              |                 |             | 1,328               |
| Non-farm, non-residential                 | 7,038               | 616                | 658              |                 |             | 8,312               |
| Agricultural                              | 26                  |                    |                  |                 |             | 26                  |
| Farmland                                  | 143                 |                    | 269              |                 |             | 412                 |
| Consumer real estate loans                |                     |                    |                  |                 |             |                     |
| Home equity lines                         | 15,092              | 22,867             | 778              |                 |             | 38,737              |
| Single family owner occupied              | 4,810               | 945                | 1,303            |                 |             | 7,058               |
| Owner occupied construction               | 105                 |                    | 96               |                 |             | 201                 |
| Consumer and other loans                  |                     |                    |                  |                 |             |                     |
| Consumer loans                            | 80                  |                    |                  |                 |             | 80                  |
| <b>Total covered loans</b>                | <b>32,106</b>       | <b>25,365</b>      | <b>4,366</b>     |                 |             | <b>61,837</b>       |
| <b>Total loans</b>                        | <b>\$ 1,721,200</b> | <b>\$ 67,636</b>   | <b>\$ 46,353</b> | <b>\$ 1,189</b> | <b>\$ 6</b> | <b>\$ 1,836,384</b> |



| December 31, 2015                         |                     |                    |                  |           |           |                     |
|-------------------------------------------|---------------------|--------------------|------------------|-----------|-----------|---------------------|
| (Amounts in thousands)                    | Pass                | Special<br>Mention | Substandard      | Doubtful  | Loss      | Total               |
| <b>Non-covered loans</b>                  |                     |                    |                  |           |           |                     |
| Commercial loans                          |                     |                    |                  |           |           |                     |
| Construction, development, and other land | \$ 46,816           | \$ 974             | \$ 1,106         | \$        | \$        | \$ 48,896           |
| Commercial and industrial                 | 87,223              | 663                | 1,017            |           |           | 88,903              |
| Multi-family residential                  | 81,168              | 12,969             | 889              |           |           | 95,026              |
| Single family non-owner occupied          | 139,680             | 3,976              | 5,695            |           |           | 149,351             |
| Non-farm, non-residential                 | 454,906             | 15,170             | 15,384           |           |           | 485,460             |
| Agricultural                              | 2,886               | 25                 |                  |           |           | 2,911               |
| Farmland                                  | 25,855              | 1,427              | 258              |           |           | 27,540              |
| Consumer real estate loans                |                     |                    |                  |           |           |                     |
| Home equity lines                         | 104,897             | 1,083              | 1,387            |           |           | 107,367             |
| Single family owner occupied              | 468,155             | 6,686              | 20,368           |           |           | 495,209             |
| Owner occupied construction               | 42,783              |                    | 722              |           |           | 43,505              |
| Consumer and other loans                  |                     |                    |                  |           |           |                     |
| Consumer loans                            | 71,685              | 61                 | 254              |           |           | 72,000              |
| Other                                     | 7,338               |                    |                  |           |           | 7,338               |
| <b>Total non-covered loans</b>            | <b>1,533,392</b>    | <b>43,034</b>      | <b>47,080</b>    |           |           | <b>1,623,506</b>    |
| <b>Covered loans</b>                      |                     |                    |                  |           |           |                     |
| Commercial loans                          |                     |                    |                  |           |           |                     |
| Construction, development, and other land | 3,908               | 1,261              | 1,134            |           |           | 6,303               |
| Commercial and industrial                 | 1,144               | 4                  | 22               |           |           | 1,170               |
| Multi-family residential                  | 460                 |                    | 180              |           |           | 640                 |
| Single family non-owner occupied          | 1,808               | 457                | 409              |           |           | 2,674               |
| Non-farm, non-residential                 | 9,192               | 2,044              | 2,829            |           |           | 14,065              |
| Agricultural                              | 34                  |                    |                  |           |           | 34                  |
| Farmland                                  | 364                 |                    | 279              |           |           | 643                 |
| Consumer real estate loans                |                     |                    |                  |           |           |                     |
| Home equity lines                         | 17,893              | 29,823             | 849              |           |           | 48,565              |
| Single family owner occupied              | 5,102               | 1,963              | 1,530            |           |           | 8,595               |
| Owner occupied construction               | 112                 | 51                 | 99               |           |           | 262                 |
| Consumer and other loans                  |                     |                    |                  |           |           |                     |
| Consumer loans                            | 84                  |                    |                  |           |           | 84                  |
| <b>Total covered loans</b>                | <b>40,101</b>       | <b>35,603</b>      | <b>7,331</b>     |           |           | <b>83,035</b>       |
| <b>Total loans</b>                        | <b>\$ 1,573,493</b> | <b>\$ 78,637</b>   | <b>\$ 54,411</b> | <b>\$</b> | <b>\$</b> | <b>\$ 1,706,541</b> |

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

The following table presents the recorded investment, unpaid principal balance, and related allowance for loan losses for impaired loans, excluding PCI loans, as of the periods indicated:

|                                                 | September 30, 2016  |                   |                   | December 31, 2015   |                   |                   |
|-------------------------------------------------|---------------------|-------------------|-------------------|---------------------|-------------------|-------------------|
|                                                 | Unpaid              |                   |                   | Unpaid              |                   |                   |
| (Amounts in thousands)                          | Recorded Investment | Principal Balance | Related Allowance | Recorded Investment | Principal Balance | Related Allowance |
| <b>Impaired loans with no related allowance</b> |                     |                   |                   |                     |                   |                   |
| Commercial loans                                |                     |                   |                   |                     |                   |                   |
| Multi-family residential                        | \$ 292              | \$ 297            | \$                | \$                  | \$                | \$                |
| Single family non-owner occupied                | 455                 | 455               |                   | 782                 | 783               |                   |
| Non-farm, non-residential                       | 5,210               | 5,352             |                   | 8,427               | 8,427             |                   |
| Consumer real estate loans                      |                     |                   |                   |                     |                   |                   |
| Single family owner occupied                    | 1,137               | 1,195             |                   | 1,975               | 2,067             |                   |
| Owner occupied construction                     | 342                 | 353               |                   |                     |                   |                   |
| Total impaired loans with no allowance          | 7,436               | 7,652             |                   | 11,184              | 11,277            |                   |
| <b>Impaired loans with a related allowance</b>  |                     |                   |                   |                     |                   |                   |
| Commercial loans                                |                     |                   |                   |                     |                   |                   |
| Single family non-owner occupied                | 676                 | 677               | 107               | 619                 | 623               | 124               |
| Non-farm, non-residential                       | 4,599               | 4,636             | 1,843             | 5,667               | 5,673             | 1,568             |
| Consumer real estate loans                      |                     |                   |                   |                     |                   |                   |
| Single family owner occupied                    | 4,083               | 4,129             | 853               | 4,899               | 4,907             | 672               |
| Owner occupied construction                     |                     |                   |                   | 349                 | 355               | 7                 |
| Total impaired loans with an allowance          | 9,358               | 9,442             | 2,803             | 11,534              | 11,558            | 2,371             |
| Total impaired loans                            | \$ 16,794           | \$ 17,094         | \$ 2,803          | \$ 22,718           | \$ 22,835         | \$ 2,371          |

The following table presents the average recorded investment and interest income recognized on impaired loans, excluding PCI loans, for the periods indicated:

|                                                 | Three Months Ended September 30, |                     |                             |                     | Nine Months Ended September 30, |                     |                             |                     |
|-------------------------------------------------|----------------------------------|---------------------|-----------------------------|---------------------|---------------------------------|---------------------|-----------------------------|---------------------|
|                                                 | 2016                             |                     | 2015                        |                     | 2016                            |                     | 2015                        |                     |
| (Amounts in thousands)                          | Average Recorded Investment      | Interest Recognized | Average Recorded Investment | Interest Recognized | Average Recorded Investment     | Interest Recognized | Average Recorded Investment | Interest Recognized |
| <b>Impaired loans with no related allowance</b> |                                  |                     |                             |                     |                                 |                     |                             |                     |
| Commercial loans                                |                                  |                     |                             |                     |                                 |                     |                             |                     |
| Multi-family residential                        | \$ 298                           | \$ 15               | \$                          | \$                  | \$ 99                           | \$ 15               | \$                          | \$                  |
| Single family non-owner occupied                | 460                              | 7                   | 792                         | 27                  | 565                             | 22                  | 571                         | 28                  |
| Non-farm, non-residential                       | 5,404                            | 60                  | 8,878                       | 72                  | 6,051                           | 181                 | 8,834                       | 295                 |
| Consumer real estate loans                      |                                  |                     |                             |                     |                                 |                     |                             |                     |

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|                              |       |    |       |  |     |    |       |     |
|------------------------------|-------|----|-------|--|-----|----|-------|-----|
| Single family owner occupied | 1,159 | 13 | 1,353 |  | 829 | 13 | 2,578 | 100 |
| Owner occupied construction  | 344   |    |       |  | 229 |    | 117   |     |

|                                        |       |    |        |    |       |     |        |     |
|----------------------------------------|-------|----|--------|----|-------|-----|--------|-----|
| Total impaired loans with no allowance | 7,665 | 95 | 11,023 | 99 | 7,773 | 231 | 12,100 | 423 |
|----------------------------------------|-------|----|--------|----|-------|-----|--------|-----|

**Impaired loans with a related allowance**

|                                  |       |    |       |    |       |     |       |    |
|----------------------------------|-------|----|-------|----|-------|-----|-------|----|
| Commercial loans                 |       |    |       |    |       |     |       |    |
| Single family non-owner occupied | 682   | 5  | 629   |    | 572   | 18  | 558   | 22 |
| Non-farm, non-residential        | 4,658 | 45 | 5,417 | 15 | 5,108 | 215 | 4,740 | 51 |
| Consumer real estate loans       |       |    |       |    |       |     |       |    |
| Single family owner occupied     | 4,130 | 24 | 4,847 | 13 | 4,547 | 91  | 3,325 | 26 |
| Owner occupied construction      |       |    | 357   | 1  | 115   |     | 119   | 1  |

|                                        |       |    |        |    |        |     |       |     |
|----------------------------------------|-------|----|--------|----|--------|-----|-------|-----|
| Total impaired loans with an allowance | 9,470 | 74 | 11,250 | 29 | 10,342 | 324 | 8,742 | 100 |
|----------------------------------------|-------|----|--------|----|--------|-----|-------|-----|

|                      |           |        |           |        |           |        |           |        |
|----------------------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|
| Total impaired loans | \$ 17,135 | \$ 169 | \$ 22,273 | \$ 128 | \$ 18,115 | \$ 555 | \$ 20,842 | \$ 523 |
|----------------------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|

The following tables present information on impaired PCI loan pools as of the dates, and for the periods, indicated:

| <i>(Amounts in thousands, except impaired pools)</i> | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|------------------------------------------------------|---------------------------|--------------------------|
| Unpaid principal balance                             | \$ 1,104                  | \$ 3,759                 |
| Recorded investment                                  | 1,104                     | 2,834                    |
| Allowance for loan losses related to PCI loan pools  | 12                        | 54                       |
| Impaired PCI loan pools                              | 1                         | 2                        |

| <i>(Amounts in thousands)</i> | <b>Three Months Ended September 30, 2016</b> |             | <b>Three Months Ended September 30, 2015</b> |             |
|-------------------------------|----------------------------------------------|-------------|----------------------------------------------|-------------|
|                               | <b>2016</b>                                  | <b>2015</b> | <b>2016</b>                                  | <b>2015</b> |
| Interest income recognized    | \$ 12                                        | \$ 96       | \$ 130                                       | \$ 273      |
| Average recorded investment   | 1,139                                        | 3,045       | 2,195                                        | 3,464       |

The Company generally places a loan on nonaccrual status when it is 90 days or more past due. PCI loans are generally not classified as nonaccrual due to the accrual of interest income under the accretion method of accounting. The following table presents nonaccrual loans, by loan class, as of the dates indicated:

| <i>(Amounts in thousands)</i>             | <b>September 30, 2016</b> |                |              | <b>December 31, 2015</b> |                |              |
|-------------------------------------------|---------------------------|----------------|--------------|--------------------------|----------------|--------------|
|                                           | <b>Non-covered</b>        | <b>Covered</b> | <b>Total</b> | <b>Non-covered</b>       | <b>Covered</b> | <b>Total</b> |
| Commercial loans                          |                           |                |              |                          |                |              |
| Construction, development, and other land | \$ 70                     | \$ 39          | \$ 109       | \$ 39                    | \$ 54          | \$ 93        |
| Commercial and industrial                 | 405                       | 14             | 419          |                          | 16             | 16           |
| Multi-family residential                  | 306                       |                | 306          | 84                       |                | 84           |
| Single family non-owner occupied          | 1,158                     | 25             | 1,183        | 1,850                    | 29             | 1,879        |
| Non-farm, non-residential                 | 7,075                     | 34             | 7,109        | 7,150                    | 39             | 7,189        |
| Farmland                                  | 135                       |                | 135          | 234                      |                | 234          |
| Consumer real estate loans                |                           |                |              |                          |                |              |
| Home equity lines                         | 527                       | 440            | 967          | 825                      | 413            | 1,238        |
| Single family owner occupied              | 7,403                     | 136            | 7,539        | 7,245                    | 96             | 7,341        |
| Owner occupied construction               | 342                       |                | 342          | 349                      |                | 349          |
| Consumer and other loans                  |                           |                |              |                          |                |              |
| Consumer loans                            | 66                        |                | 66           | 71                       |                | 71           |
| Total nonaccrual loans                    | \$ 17,487                 | \$ 688         | \$ 18,175    | \$ 17,847                | \$ 647         | \$ 18,494    |



The following tables present the aging of past due loans, by loan class, as of the dates indicated. Nonaccrual loans 30 days or more past due are included in the applicable delinquency category. Loans acquired with credit deterioration, with a discount, continue to accrue interest based on expected cash flows; therefore, PCI loans are not generally considered nonaccrual. Non-covered accruing loans contractually past due 90 days or more totaled \$62 thousand as of September 30, 2016. No non-covered accruing loans were contractually past due 90 days or more as of December 31, 2015.

|                                           | September 30, 2016          |                          |                         |                      |                  |                |
|-------------------------------------------|-----------------------------|--------------------------|-------------------------|----------------------|------------------|----------------|
|                                           | 30 - 59 Days<br>Past<br>Due | 60 - 89 Days<br>Past Due | 90+ Days<br>Past<br>Due | Total<br>Past<br>Due | Current<br>Loans | Total<br>Loans |
| (Amounts in thousands)                    |                             |                          |                         |                      |                  |                |
| Non-covered loans                         |                             |                          |                         |                      |                  |                |
| Commercial loans                          |                             |                          |                         |                      |                  |                |
| Construction, development, and other land | \$ 5                        | \$ 64                    | \$ 53                   | \$ 122               | \$ 49,677        | \$ 49,799      |
| Commercial and industrial                 | 121                         | 31                       | 171                     | 323                  | 90,039           | 90,362         |
| Multi-family residential                  | 283                         | 71                       | 306                     | 660                  | 126,808          | 127,468        |
| Single family non-owner occupied          | 110                         | 305                      | 780                     | 1,195                | 142,828          | 144,023        |
| Non-farm, non-residential                 | 4,726                       | 277                      | 2,451                   | 7,454                | 588,561          | 596,015        |
| Agricultural                              | 255                         |                          |                         | 255                  | 5,531            | 5,786          |
| Farmland                                  | 72                          | 576                      |                         | 648                  | 31,326           | 31,974         |
| Consumer real estate loans                |                             |                          |                         |                      |                  |                |
| Home equity lines                         | 377                         | 169                      | 394                     | 940                  | 107,168          | 108,108        |
| Single family owner occupied              | 4,123                       | 1,875                    | 2,950                   | 8,948                | 488,747          | 497,695        |
| Owner occupied construction               | 251                         |                          | 342                     | 593                  | 43,332           | 43,925         |
| Consumer and other loans                  |                             |                          |                         |                      |                  |                |
| Consumer loans                            | 576                         | 114                      | 32                      | 722                  | 75,641           | 76,363         |
| Other                                     |                             |                          |                         |                      | 3,029            | 3,029          |
| Total non-covered loans                   | 10,899                      | 3,482                    | 7,479                   | 21,860               | 1,752,687        | 1,774,547      |
| Covered loans                             |                             |                          |                         |                      |                  |                |
| Commercial loans                          |                             |                          |                         |                      |                  |                |
| Construction, development, and other land | 105                         |                          | 39                      | 144                  | 4,555            | 4,699          |
| Commercial and industrial                 |                             |                          |                         |                      | 941              | 941            |
| Multi-family residential                  |                             |                          |                         |                      | 43               | 43             |
| Single family non-owner occupied          | 25                          |                          |                         | 25                   | 1,303            | 1,328          |
| Non-farm, non-residential                 |                             |                          |                         |                      | 8,312            | 8,312          |
| Agricultural                              |                             |                          |                         |                      | 26               | 26             |
| Farmland                                  |                             |                          |                         |                      | 412              | 412            |
| Consumer real estate loans                |                             |                          |                         |                      |                  |                |
| Home equity lines                         | 333                         | 43                       | 24                      | 400                  | 38,337           | 38,737         |
| Single family owner occupied              | 232                         | 26                       | 92                      | 350                  | 6,708            | 7,058          |
| Owner occupied construction               |                             |                          |                         |                      | 201              | 201            |
| Consumer and other loans                  |                             |                          |                         |                      |                  |                |
| Consumer loans                            |                             |                          |                         |                      | 80               | 80             |

|                     |           |          |          |           |              |              |
|---------------------|-----------|----------|----------|-----------|--------------|--------------|
| Total covered loans | 695       | 69       | 155      | 919       | 60,918       | 61,837       |
| Total loans         | \$ 11,594 | \$ 3,551 | \$ 7,634 | \$ 22,779 | \$ 1,813,605 | \$ 1,836,384 |

|                                           | December 31, 2015           |                          |                         |                      |                     |                     |
|-------------------------------------------|-----------------------------|--------------------------|-------------------------|----------------------|---------------------|---------------------|
|                                           | 30 - 59 Days<br>Past<br>Due | 60 - 89 Days<br>Past Due | 90+ Days<br>Past<br>Due | Total<br>Past<br>Due | Current<br>Loans    | Total<br>Loans      |
| <i>(Amounts in thousands)</i>             |                             |                          |                         |                      |                     |                     |
| <b>Non-covered loans</b>                  |                             |                          |                         |                      |                     |                     |
| Commercial loans                          |                             |                          |                         |                      |                     |                     |
| Construction, development, and other land | \$                          | \$                       | \$ 39                   | \$ 39                | \$ 48,857           | \$ 48,896           |
| Commercial and industrial                 | 281                         | 66                       |                         | 347                  | 88,556              | 88,903              |
| Multi-family residential                  | 302                         | 76                       | 84                      | 462                  | 94,564              | 95,026              |
| Single family non-owner occupied          | 748                         | 120                      | 929                     | 1,797                | 147,554             | 149,351             |
| Non-farm, non-residential                 | 347                         | 676                      | 4,940                   | 5,963                | 479,497             | 485,460             |
| Agricultural                              |                             |                          |                         |                      | 2,911               | 2,911               |
| Farmland                                  | 585                         | 11                       | 234                     | 830                  | 26,710              | 27,540              |
| Consumer real estate loans                |                             |                          |                         |                      |                     |                     |
| Home equity lines                         | 668                         | 195                      | 468                     | 1,331                | 106,036             | 107,367             |
| Single family owner occupied              | 6,122                       | 1,943                    | 3,191                   | 11,256               | 483,953             | 495,209             |
| Owner occupied construction               |                             |                          |                         |                      | 43,505              | 43,505              |
| Consumer and other loans                  |                             |                          |                         |                      |                     |                     |
| Consumer loans                            | 278                         | 71                       | 23                      | 372                  | 71,628              | 72,000              |
| Other                                     |                             |                          |                         |                      | 7,338               | 7,338               |
| <b>Total non-covered loans</b>            | <b>9,331</b>                | <b>3,158</b>             | <b>9,908</b>            | <b>22,397</b>        | <b>1,601,109</b>    | <b>1,623,506</b>    |
| <b>Covered loans</b>                      |                             |                          |                         |                      |                     |                     |
| Commercial loans                          |                             |                          |                         |                      |                     |                     |
| Construction, development, and other land | 96                          |                          | 42                      | 138                  | 6,165               | 6,303               |
| Commercial and industrial                 |                             |                          | 16                      | 16                   | 1,154               | 1,170               |
| Multi-family residential                  |                             |                          |                         |                      | 640                 | 640                 |
| Single family non-owner occupied          | 1,422                       |                          |                         | 1,422                | 1,252               | 2,674               |
| Non-farm, non-residential                 |                             |                          | 39                      | 39                   | 14,026              | 14,065              |
| Agricultural                              |                             |                          |                         |                      | 34                  | 34                  |
| Farmland                                  |                             |                          |                         |                      | 643                 | 643                 |
| Consumer real estate loans                |                             |                          |                         |                      |                     |                     |
| Home equity lines                         | 489                         | 37                       | 225                     | 751                  | 47,814              | 48,565              |
| Single family owner occupied              | 274                         |                          | 42                      | 316                  | 8,279               | 8,595               |
| Owner occupied construction               |                             |                          |                         |                      | 262                 | 262                 |
| Consumer and other loans                  |                             |                          |                         |                      |                     |                     |
| Consumer loans                            |                             |                          |                         |                      | 84                  | 84                  |
| <b>Total covered loans</b>                | <b>2,281</b>                | <b>37</b>                | <b>364</b>              | <b>2,682</b>         | <b>80,353</b>       | <b>83,035</b>       |
| <b>Total loans</b>                        | <b>\$ 11,612</b>            | <b>\$ 3,195</b>          | <b>\$ 10,272</b>        | <b>\$ 25,079</b>     | <b>\$ 1,681,462</b> | <b>\$ 1,706,541</b> |

The Company may make concessions in interest rates, loan terms and/or amortization terms when restructuring loans for borrowers experiencing financial difficulty. Restructured loans in excess of \$250 thousand are evaluated for a specific reserve based on either the collateral or net present value method, whichever is most applicable. Restructured loans under \$250 thousand are subject to the reserve calculation at the historical loss rate for classified loans. Certain troubled debt restructurings ( TDRs ) are classified as nonperforming at the time of restructuring and are returned to

performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs. PCI loans are generally not considered TDRs as long as the loans remain in the assigned loan pool. No covered loans were recorded as TDRs as of September 30, 2016, or December 31, 2015.

The following table presents loans modified as TDRs, by loan class, segregated by accrual status, as of the dates indicated:

| (Amounts in thousands)                    | September 30, 2016        |           |           | December 31, 2015         |           |           |
|-------------------------------------------|---------------------------|-----------|-----------|---------------------------|-----------|-----------|
|                                           | Nonaccrual <sup>(1)</sup> | Accrual   | Total     | Nonaccrual <sup>(1)</sup> | Accrual   | Total     |
| Commercial loans                          |                           |           |           |                           |           |           |
| Single family non-owner occupied          | \$ 39                     | \$ 898    | \$ 937    | \$ 130                    | \$ 820    | \$ 950    |
| Non-farm, non-residential                 |                           | 4,205     | 4,205     |                           | 4,600     | 4,600     |
| Consumer real estate loans                |                           |           |           |                           |           |           |
| Home equity lines                         |                           | 162       | 162       | 127                       | 43        | 170       |
| Single family owner occupied              | 929                       | 7,947     | 8,876     | 733                       | 8,256     | 8,989     |
| Owner occupied construction               | 343                       | 239       | 582       | 349                       | 243       | 592       |
| Total TDRs                                | \$ 1,311                  | \$ 13,451 | \$ 14,762 | \$ 1,339                  | \$ 13,962 | \$ 15,301 |
| Allowance for loan losses related to TDRs |                           |           | \$ 552    |                           |           | \$ 590    |

(1) Nonaccrual TDRs are included in total nonaccrual loans disclosed in the nonaccrual table above. The following table presents interest income recognized on TDRs for the periods indicated:

| (Amounts in thousands)     | Three Months Ended September 30, 2016 |        | Three Months Ended September 30, 2015 |        |
|----------------------------|---------------------------------------|--------|---------------------------------------|--------|
|                            | 2016                                  | 2015   | 2016                                  | 2015   |
| Interest income recognized | \$ 143                                | \$ 148 | \$ 296                                | \$ 456 |

The following tables present loans modified as TDRs, by type of concession made and loan class, that were restructured during the periods indicated. The post-modification recorded investment represents the loan balance immediately following modification.

|                                                                                         | Three Months Ended September 30, 2016 |                                          |                                     |                                          | Three Months Ended September 30, 2015 |                                          |                                     |                                          |
|-----------------------------------------------------------------------------------------|---------------------------------------|------------------------------------------|-------------------------------------|------------------------------------------|---------------------------------------|------------------------------------------|-------------------------------------|------------------------------------------|
|                                                                                         | Total Pre-modification<br>Contracts   | Post-modification<br>Recorded Investment | Total Pre-modification<br>Contracts | Post-modification<br>Recorded Investment | Total Pre-modification<br>Contracts   | Post-modification<br>Recorded Investment | Total Pre-modification<br>Contracts | Post-modification<br>Recorded Investment |
| (Amounts in thousands)                                                                  |                                       |                                          |                                     |                                          |                                       |                                          |                                     |                                          |
| Below market interest rate and<br>extended payment term Single<br>family owner occupied | \$                                    | \$                                       | 4                                   | \$                                       | 307                                   | \$                                       | 307                                 | \$                                       |
| Total                                                                                   | \$                                    | \$                                       | 4                                   | \$                                       | 307                                   | \$                                       | 307                                 | \$                                       |

| (Amounts in thousands) | Nine Months Ended September 30, 2016 |                                       |                                  |                                       | Nine Months Ended September 30, 2015 |                                       |                                  |                                       |
|------------------------|--------------------------------------|---------------------------------------|----------------------------------|---------------------------------------|--------------------------------------|---------------------------------------|----------------------------------|---------------------------------------|
|                        | Total Pre-modification Contracts     | Post-modification Recorded Investment | Total Pre-modification Contracts | Post-modification Recorded Investment | Total Pre-modification Contracts     | Post-modification Recorded Investment | Total Pre-modification Contracts | Post-modification Recorded Investment |

|                                                                                   |   | <b>Investment</b> |     | <b>Investment</b> |     | <b>Investment</b> |    | <b>Investment</b> |        |
|-----------------------------------------------------------------------------------|---|-------------------|-----|-------------------|-----|-------------------|----|-------------------|--------|
| Below market interest rate and extended payment term Single family owner occupied | 1 | \$                | 115 | \$                | 115 | 5                 | \$ | 342               | \$ 342 |
| Total                                                                             | 1 | \$                | 115 | \$                | 115 | 5                 | \$ | 342               | \$ 342 |

The following table presents loans modified as TDRs, by loan class, that were restructured within the previous 12 months for which there was a payment default during the periods indicated:

|                                  | <b>Three Months Ended September 30,</b> |                            |                  |                            |
|----------------------------------|-----------------------------------------|----------------------------|------------------|----------------------------|
|                                  | <b>2016</b>                             |                            | <b>2015</b>      |                            |
| <i>(Amounts in thousands)</i>    | <b>Total</b>                            | <b>Post-modification</b>   | <b>Total</b>     | <b>Post-modification</b>   |
|                                  | <b>Contracts</b>                        | <b>Recorded Investment</b> | <b>Contracts</b> | <b>Recorded Investment</b> |
| Commercial loans                 |                                         |                            |                  |                            |
| Single family non-owner occupied |                                         | \$                         | 1                | \$ 78                      |
| Total                            |                                         | \$                         | 1                | \$ 78                      |

|                                  | Nine Months Ended September 30, |                                       | 2015           |                                       |
|----------------------------------|---------------------------------|---------------------------------------|----------------|---------------------------------------|
|                                  | Total Contract                  | Post-modification Recorded Investment | Total Contract | Post-modification Recorded Investment |
| <i>(Amounts in thousands)</i>    |                                 |                                       |                |                                       |
| Commercial loans                 |                                 |                                       |                |                                       |
| Single family non-owner occupied | \$                              | 1                                     | \$             | 78                                    |
| Consumer real estate loans       |                                 |                                       |                |                                       |
| Owner occupied construction      |                                 | 1                                     |                | 353                                   |
| Total                            | \$                              | 2                                     | \$             | 431                                   |

The following table presents information for other real estate owned ( OREO ), which consists of properties acquired through foreclosure, as of the dates indicated:

| <i>(Amounts in thousands)</i>                                           | September 30, 2016 | December 31, 2015 |
|-------------------------------------------------------------------------|--------------------|-------------------|
| Non-covered OREO                                                        | \$ 4,052           | \$ 4,873          |
| Covered OREO                                                            | 2,437              | 4,034             |
| Total OREO                                                              | \$ 6,489           | \$ 8,907          |
| Non-covered OREO secured by residential real estate                     | \$ 1,688           | \$ 2,677          |
| Residential real estate loans in the foreclosure process <sup>(1)</sup> | 3,639              | 2,727             |

- (1) The recorded investment in consumer mortgage loans collateralized by residential real estate that are in the process of foreclosure according to local requirements of the applicable jurisdiction

#### **Note 6. Allowance for Loan Losses**

The allowance for loan losses is maintained at a level management deems adequate to absorb probable loan losses inherent in the loan portfolio. The allowance is increased by provisions charged to operations and reduced by net charge-offs. While management uses its best judgment and information available, the allowance's ultimate adequacy is dependent on a variety of factors that may be beyond the Company's control: the performance of the Company's loan portfolio, the economy, changes in interest rates, the view of regulatory authorities towards loan classifications, and other factors. These uncertainties may result in a material change to the allowance for loan losses in the near term; however, the amount of the change cannot reasonably be estimated.

The Company's allowance consists of specific reserves on loans individually evaluated, including credit relationships, and general reserves on loans not individually evaluated, which are segmented into groups with similar risk characteristics based on an internal risk grading matrix. General reserve allocations are based on management's judgments of qualitative and quantitative factors about macro and micro economic conditions reflected within the loan portfolio and the economy. Loans acquired in business combinations that are deemed impaired at acquisition are grouped into pools and evaluated separately from the non-PCI portfolio. The PCI loan provision is offset by an adjustment to the FDIC indemnification asset to reflect the indemnified portion, 80%, of the post-acquisition exposure. While allocations are made to various portfolio segments, the allowance for loan losses is available for use against any loan loss management deems appropriate, excluding reserves allocated to specific loans and PCI loan pools. Management believed the allowance was adequate to absorb probable loan losses inherent in the loan portfolio

as of September 30, 2016.



The following tables present the activity in the allowance for loan losses, by loan segment, for the periods indicated:

| <i>(Amounts in thousands)</i>                                           | Three Months Ended September 30, 2016 |                      |                    |                 |
|-------------------------------------------------------------------------|---------------------------------------|----------------------|--------------------|-----------------|
|                                                                         | Commercial                            | Consumer Real Estate | Consumer and Other | Total Allowance |
| <b>Allowance, excluding PCI</b>                                         |                                       |                      |                    |                 |
| Beginning balance                                                       | \$ 13,689                             | \$ 6,625             | \$ 773             | \$ 21,087       |
| (Recovery of) provision for loan losses charged to operations           | (726)                                 | (575)                | 147                | (1,154)         |
| Charge-offs                                                             | (272)                                 | (207)                | (293)              | (772)           |
| Recoveries                                                              | 295                                   | 89                   | 76                 | 460             |
| Net recoveries (charge-offs)                                            | 23                                    | (118)                | (217)              | (312)           |
| Ending balance                                                          | \$ 12,986                             | \$ 5,932             | \$ 703             | \$ 19,621       |
| <b>PCI allowance</b>                                                    |                                       |                      |                    |                 |
| Beginning balance                                                       | \$                                    | \$ 12                | \$                 | \$ 12           |
| Recovery of loan losses                                                 |                                       |                      |                    |                 |
| Benefit attributable to the FDIC indemnification asset                  |                                       |                      |                    |                 |
| Recovery of loan losses charged to operations                           |                                       |                      |                    |                 |
| Recovery of loan losses recorded through the FDIC indemnification asset |                                       |                      |                    |                 |
| Ending balance                                                          | \$                                    | \$ 12                | \$                 | \$ 12           |
| <b>Total allowance</b>                                                  |                                       |                      |                    |                 |
| Beginning balance                                                       | \$ 13,689                             | \$ 6,637             | \$ 773             | \$ 21,099       |
| (Recovery of) provision for loan losses                                 | (726)                                 | (575)                | 147                | (1,154)         |
| Benefit attributable to the FDIC indemnification asset                  |                                       |                      |                    |                 |
| (Recovery of) provision for loan losses charged to operations           | (726)                                 | (575)                | 147                | (1,154)         |
| Recovery of loan losses recorded through the FDIC indemnification asset |                                       |                      |                    |                 |
| Charge-offs                                                             | (272)                                 | (207)                | (293)              | (772)           |
| Recoveries                                                              | 295                                   | 89                   | 76                 | 460             |
| Net recoveries (charge-offs)                                            | 23                                    | (118)                | (217)              | (312)           |
| Ending balance                                                          | \$ 12,986                             | \$ 5,944             | \$ 703             | \$ 19,633       |



| Three Months Ended September 30, 2015                                   |            |                      |                    |                 |
|-------------------------------------------------------------------------|------------|----------------------|--------------------|-----------------|
| (Amounts in thousands)                                                  | Commercial | Consumer Real Estate | Consumer and Other | Total Allowance |
| <b>Allowance, excluding PCI</b>                                         |            |                      |                    |                 |
| Beginning balance                                                       | \$ 12,995  | \$ 6,468             | \$ 681             | \$ 20,144       |
| Provision for loan losses charged to operations                         | 6          | 20                   | 374                | 400             |
| Charge-offs                                                             | (150)      | (130)                | (409)              | (689)           |
| Recoveries                                                              | 102        | 86                   | 64                 | 252             |
| Net charge-offs                                                         | (48)       | (44)                 | (345)              | (437)           |
| Ending balance                                                          | \$ 12,953  | \$ 6,444             | \$ 710             | \$ 20,107       |
| <b>PCI allowance</b>                                                    |            |                      |                    |                 |
| Beginning balance                                                       | \$         | \$ 114               | \$                 | \$ 114          |
| Recovery of loan losses                                                 |            | (94)                 |                    | (94)            |
| Benefit attributable to the FDIC indemnification asset                  |            | 75                   |                    | 75              |
| Recovery of loan losses charged to operations                           |            | (19)                 |                    | (19)            |
| Recovery of loan losses recorded through the FDIC indemnification asset |            | (75)                 |                    | (75)            |
| Ending balance                                                          | \$         | \$ 20                | \$                 | \$ 20           |
| <b>Total allowance</b>                                                  |            |                      |                    |                 |
| Beginning balance                                                       | \$ 12,995  | \$ 6,582             | \$ 681             | \$ 20,258       |
| Provision for (recovery of) loan losses                                 | 6          | (74)                 | 374                | 306             |
| Benefit attributable to the FDIC indemnification asset                  |            | 75                   |                    | 75              |
| Provision for loan losses charged to operations                         | 6          | 1                    | 374                | 381             |
| Recovery of loan losses recorded through the FDIC indemnification asset |            | (75)                 |                    | (75)            |
| Charge-offs                                                             | (150)      | (130)                | (409)              | (689)           |
| Recoveries                                                              | 102        | 86                   | 64                 | 252             |
| Net charge-offs                                                         | (48)       | (44)                 | (345)              | (437)           |
| Ending balance                                                          | \$ 12,953  | \$ 6,464             | \$ 710             | \$ 20,127       |

| Nine Months Ended September 30, 2016                                    |            |                      |                    |                 |
|-------------------------------------------------------------------------|------------|----------------------|--------------------|-----------------|
| (Amounts in thousands)                                                  | Commercial | Consumer Real Estate | Consumer and Other | Total Allowance |
| <b>Allowance, excluding PCI</b>                                         |            |                      |                    |                 |
| Beginning balance                                                       | \$ 13,133  | \$ 6,356             | \$ 690             | \$ 20,179       |
| (Recovery of) provision for loan losses charged to operations           | (200)      | 436                  | 560                | 796             |
| Charge-offs                                                             | (747)      | (1,135)              | (809)              | (2,691)         |
| Recoveries                                                              | 800        | 275                  | 262                | 1,337           |
| Net recoveries (charge-offs)                                            | 53         | (860)                | (547)              | (1,354)         |
| Ending balance                                                          | \$ 12,986  | \$ 5,932             | \$ 703             | \$ 19,621       |
| <b>PCI allowance</b>                                                    |            |                      |                    |                 |
| Beginning balance                                                       | \$         | \$ 54                | \$                 | \$ 54           |
| Recovery of loan losses                                                 |            | (42)                 |                    | (42)            |
| Benefit attributable to the FDIC indemnification asset                  |            | 1                    |                    | 1               |
| Recovery of loan losses charged to operations                           |            | (41)                 |                    | (41)            |
| Recovery of loan losses recorded through the FDIC indemnification asset |            | (1)                  |                    | (1)             |
| Ending balance                                                          | \$         | \$ 12                | \$                 | \$ 12           |
| <b>Total allowance</b>                                                  |            |                      |                    |                 |
| Beginning balance                                                       | \$ 13,133  | \$ 6,410             | \$ 690             | \$ 20,233       |
| (Recovery of) provision for loan losses                                 | (200)      | 394                  | 560                | 754             |
| Benefit attributable to the FDIC indemnification asset                  |            | 1                    |                    | 1               |
| (Recovery of) provision for loan losses charged to operations           | (200)      | 395                  | 560                | 755             |
| Recovery of loan losses recorded through the FDIC indemnification asset |            | (1)                  |                    | (1)             |
| Charge-offs                                                             | (747)      | (1,135)              | (809)              | (2,691)         |
| Recoveries                                                              | 800        | 275                  | 262                | 1,337           |
| Net recoveries (charge-offs)                                            | 53         | (860)                | (547)              | (1,354)         |
| Ending balance                                                          | \$ 12,986  | \$ 5,944             | \$ 703             | \$ 19,633       |

| Nine Months Ended September 30, 2015                                                    |            |                      |                    |                 |
|-----------------------------------------------------------------------------------------|------------|----------------------|--------------------|-----------------|
| (Amounts in thousands)                                                                  | Commercial | Consumer Real Estate | Consumer and Other | Total Allowance |
| <b>Allowance, excluding PCI</b>                                                         |            |                      |                    |                 |
| Beginning balance                                                                       | \$ 13,010  | \$ 6,489             | \$ 670             | \$ 20,169       |
| Provision for loan losses charged to operations                                         | 754        | 136                  | 876                | 1,766           |
| Charge-offs                                                                             | (1,111)    | (622)                | (1,207)            | (2,940)         |
| Recoveries                                                                              | 300        | 441                  | 371                | 1,112           |
| Net charge-offs                                                                         | (811)      | (181)                | (836)              | (1,828)         |
| Ending balance                                                                          | \$ 12,953  | \$ 6,444             | \$ 710             | \$ 20,107       |
| <b>PCI allowance</b>                                                                    |            |                      |                    |                 |
| Beginning balance                                                                       | \$ 37      | \$ 21                | \$                 | \$ 58           |
| Recovery of loan losses                                                                 | (37)       | (1)                  |                    | (38)            |
| Benefit attributable to the FDIC indemnification asset                                  | 30         | (1)                  |                    | 29              |
| Recovery of loan losses charged to operations                                           | (7)        | (2)                  |                    | (9)             |
| (Recovery of) provision for loan losses recorded through the FDIC indemnification asset | (30)       | 1                    |                    | (29)            |
| Ending balance                                                                          | \$         | \$ 20                | \$                 | \$ 20           |
| <b>Total allowance</b>                                                                  |            |                      |                    |                 |
| Beginning balance                                                                       | \$ 13,047  | \$ 6,510             | \$ 670             | \$ 20,227       |
| Provision for loan losses                                                               | 717        | 135                  | 876                | 1,728           |
| Benefit attributable to the FDIC indemnification asset                                  | 30         | (1)                  |                    | 29              |
| Provision for loan losses charged to operations                                         | 747        | 134                  | 876                | 1,757           |
| (Recovery of) provision for loan losses recorded through the FDIC indemnification asset | (30)       | 1                    |                    | (29)            |
| Charge-offs                                                                             | (1,111)    | (622)                | (1,207)            | (2,940)         |
| Recoveries                                                                              | 300        | 441                  | 371                | 1,112           |
| Net charge-offs                                                                         | (811)      | (181)                | (836)              | (1,828)         |
| Ending balance                                                                          | \$ 12,953  | \$ 6,464             | \$ 710             | \$ 20,127       |

The following tables present the allowance for loan losses and recorded investment in loans evaluated for impairment, excluding PCI loans, by loan class, as of the dates indicated:

| September 30, 2016                        |                          |                                            |                          |                        |
|-------------------------------------------|--------------------------|--------------------------------------------|--------------------------|------------------------|
| (Amounts in thousands)                    | Loans Individually       |                                            | Loans Collectively       | Allowance for Loans    |
|                                           | Evaluated for Impairment | Allowance for Loans Individually Evaluated | Evaluated for Impairment | Collectively Evaluated |
| Commercial loans                          |                          |                                            |                          |                        |
| Construction, development, and other land | \$                       | \$                                         | \$ 53,181                | \$ 813                 |
| Commercial and industrial                 |                          |                                            | 91,274                   | 473                    |
| Multi-family residential                  | 292                      |                                            | 127,176                  | 1,259                  |
| Single family non-owner occupied          | 1,131                    | 107                                        | 141,624                  | 2,553                  |
| Non-farm, non-residential                 | 9,809                    | 1,843                                      | 589,975                  | 5,706                  |
| Agricultural                              |                          |                                            | 5,812                    | 41                     |
| Farmland                                  |                          |                                            | 32,386                   | 191                    |
| Total commercial loans                    | 11,232                   | 1,950                                      | 1,041,428                | 11,036                 |
| Consumer real estate loans                |                          |                                            |                          |                        |
| Home equity lines                         |                          |                                            | 124,589                  | 967                    |
| Single family owner occupied              | 5,220                    | 853                                        | 498,561                  | 3,766                  |
| Owner occupied construction               | 342                      |                                            | 43,744                   | 346                    |
| Total consumer real estate loans          | 5,562                    | 853                                        | 666,894                  | 5,079                  |
| Consumer and other loans                  |                          |                                            |                          |                        |
| Consumer loans                            |                          |                                            | 76,443                   | 703                    |
| Other                                     |                          |                                            | 3,029                    |                        |
| Total consumer and other loans            |                          |                                            | 79,472                   | 703                    |
| Total loans, excluding PCI loans          | \$ 16,794                | \$ 2,803                                   | \$ 1,787,794             | \$ 16,818              |

| December 31, 2015                         |                          |                                            |                          |                        |
|-------------------------------------------|--------------------------|--------------------------------------------|--------------------------|------------------------|
| (Amounts in thousands)                    | Loans Individually       |                                            | Loans Collectively       | Allowance for Loans    |
|                                           | Evaluated for Impairment | Allowance for Loans Individually Evaluated | Evaluated for Impairment | Collectively Evaluated |
| Commercial loans                          |                          |                                            |                          |                        |
| Construction, development, and other land | \$                       | \$                                         | \$ 53,437                | \$ 1,119               |
| Commercial and industrial                 |                          |                                            | 89,885                   | 504                    |

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|                                  |           |          |              |           |
|----------------------------------|-----------|----------|--------------|-----------|
| Multi-family residential         |           |          | 95,486       | 1,535     |
| Single family non-owner occupied | 1,401     | 124      | 147,209      | 3,245     |
| Non-farm, non-residential        | 14,094    | 1,568    | 478,839      | 4,825     |
| Agricultural                     |           |          | 2,945        | 22        |
| Farmland                         |           |          | 28,183       | 190       |
| Total commercial loans           | 15,495    | 1,692    | 895,984      | 11,440    |
| Consumer real estate loans       |           |          |              |           |
| Home equity lines                |           |          | 126,691      | 1,091     |
| Single family owner occupied     | 6,874     | 672      | 495,761      | 4,297     |
| Owner occupied construction      | 349       | 7        | 43,323       | 290       |
| Total consumer real estate loans | 7,223     | 679      | 665,775      | 5,678     |
| Consumer and other loans         |           |          |              |           |
| Consumer loans                   |           |          | 72,084       | 690       |
| Other                            |           |          | 7,338        |           |
| Total consumer and other loans   |           |          | 79,422       | 690       |
| Total loans, excluding PCI loans | \$ 22,718 | \$ 2,371 | \$ 1,641,181 | \$ 17,808 |

The following table presents the allowance for loan losses on PCI loans and recorded investment in PCI loans, by loan pool, as of the dates indicated:

| <i>(Amounts in thousands)</i>       | September 30, 2016  |                                          | December 31, 2015   |                                          |
|-------------------------------------|---------------------|------------------------------------------|---------------------|------------------------------------------|
|                                     | Recorded Investment | Allowance for Loan Pools With Impairment | Recorded Investment | Allowance for Loan Pools With Impairment |
| Commercial loans                    |                     |                                          |                     |                                          |
| Waccamaw commercial                 | \$ 1,208            | \$                                       | \$ 3,788            | \$                                       |
| Peoples commercial                  | 4,694               |                                          | 5,525               |                                          |
| Other                               | 1,121               |                                          | 1,254               |                                          |
| Total commercial loans              | 7,023               |                                          | 10,567              |                                          |
| Consumer real estate loans          |                     |                                          |                     |                                          |
| Waccamaw serviced home equity lines | 22,256              |                                          | 29,241              |                                          |
| Waccamaw residential                | 1,413               |                                          | 1,678               | 1                                        |
| Peoples residential                 | 1,104               | 12                                       | 1,156               | 53                                       |
| Total consumer real estate loans    | 24,773              | 12                                       | 32,075              | 54                                       |
| Total PCI loans                     | \$ 31,796           | \$ 12                                    | \$ 42,642           | \$ 54                                    |

#### Note 7. FDIC Indemnification Asset

In connection with the FDIC-assisted acquisition of Waccamaw Bank ( Waccamaw ) in 2012, the Company entered into loss share agreements with the FDIC that covered \$61.84 million of loans and \$2.44 million of OREO as of September 30, 2016, compared to \$83.04 million of loans and \$4.03 million of OREO as of December 31, 2015. Under the loss share agreements, the FDIC agrees to cover 80% of most loan and foreclosed real estate losses and reimburse certain expenses incurred in relation to these covered assets. The Company's consolidated statements of income include the expense on covered assets net of estimated reimbursements. The following table presents activity in the FDIC indemnification asset for the periods indicated:

| <i>(Amounts in thousands)</i>                 | Three Months Ended September 30, 2016 |           | Three Months Ended September 30, 2015 |           |
|-----------------------------------------------|---------------------------------------|-----------|---------------------------------------|-----------|
|                                               | 2016                                  | 2015      | 2016                                  | 2015      |
| Beginning balance                             | \$ 16,431                             | \$ 23,653 | \$ 20,844                             | \$ 27,900 |
| Decrease in estimated losses on covered loans |                                       | (75)      | (1)                                   | (29)      |
| Increase in estimated losses on covered OREO  | 277                                   | 801       | 851                                   | 1,359     |
| Reimbursable expenses from the FDIC           | 60                                    | 44        | 134                                   | 409       |
| Net amortization                              | (1,369)                               | (1,768)   | (3,856)                               | (5,179)   |
| Reimbursements from the FDIC                  | (1,067)                               | (606)     | (3,640)                               | (2,411)   |
| Ending balance                                | \$ 14,332                             | \$ 22,049 | \$ 14,332                             | \$ 22,049 |





**Note 8. Deposits**

The following table presents the components of deposits as of the dates indicated:

| <i>(Amounts in thousands)</i>       | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|-------------------------------------|---------------------------|--------------------------|
| Noninterest-bearing demand deposits | \$ 473,509                | \$ 451,511               |
| Interest-bearing deposits           |                           |                          |
| Interest-bearing demand deposits    | 339,563                   | 347,705                  |
| Money market accounts               | 199,648                   | 213,982                  |
| Savings deposits                    | 322,076                   | 316,603                  |
| Certificates of deposit             | 393,567                   | 408,519                  |
| Individual retirement accounts      | 133,536                   | 134,939                  |
| Total interest-bearing deposits     | 1,388,390                 | 1,421,748                |
| Total deposits                      | \$ 1,861,899              | \$ 1,873,259             |

**Note 9. Borrowings**

The following table presents the components of borrowings as of the dates indicated:

| <i>(Amounts in thousands)</i>                        | <b>September 30, 2016</b> |                                            | <b>December 31, 2015</b> |                                            |
|------------------------------------------------------|---------------------------|--------------------------------------------|--------------------------|--------------------------------------------|
|                                                      | <b>Balance</b>            | <b>Weighted Average Rate<sup>(1)</sup></b> | <b>Balance</b>           | <b>Weighted Average Rate<sup>(1)</sup></b> |
| Securities sold under agreements to repurchase       |                           |                                            |                          |                                            |
| Retail                                               | \$ 68,532                 | 0.07%                                      | \$ 88,614                | 0.13%                                      |
| Wholesale                                            | 50,000                    | 3.71%                                      | 50,000                   | 3.71%                                      |
| Total securities sold under agreements to repurchase | 118,532                   |                                            | 138,614                  |                                            |
| FHLB borrowings                                      |                           |                                            |                          |                                            |
| Short-term advances                                  | 25,000                    | 0.36%                                      |                          |                                            |
| Long-term advances                                   | 65,000                    | 4.04%                                      | 65,000                   | 4.04%                                      |
| Total FHLB borrowings                                | 90,000                    | 3.01%                                      | 65,000                   | 4.04%                                      |
| Subordinated debt                                    | 15,464                    | 3.59%                                      | 15,464                   | 3.23%                                      |
| Other debt                                           | 243                       |                                            | 292                      |                                            |
| Total borrowings                                     | \$ 224,239                |                                            | \$ 219,370               |                                            |

(1) Weighted average contractual rate

The following schedule presents the remaining contractual maturities of repurchase agreements, by type of collateral pledged, as of September 30, 2016:

| <i>(Amounts in thousands)</i> | <b>U.S. Agency<br/>Securities</b> | <b>Municipal Securities</b> | <b>Mortgage-backed<br/>Agency Securities</b> | <b>Total</b> |
|-------------------------------|-----------------------------------|-----------------------------|----------------------------------------------|--------------|
| Overnight and continuous      | \$ 19,542                         | \$ 41,858                   | \$ 4,663                                     | \$ 66,063    |
| Up to 30 days                 |                                   |                             | 202                                          | 202          |
| 30 - 90 days                  |                                   |                             | 177                                          | 177          |
| Greater than 90 days          |                                   | 1,447                       | 50,643                                       | 52,090       |
|                               | \$ 19,542                         | \$ 43,305                   | \$ 55,685                                    | \$ 118,532   |

Investment securities pledged to secure repurchase agreements remain under the Company's control during the agreements' terms. The counterparties may redeem callable repurchase agreements, which could substantially shorten the borrowings' lives. The prepayment or unwind of a repurchase agreement may result in substantial penalties based on market conditions.

The following schedule presents the remaining contractual maturities of wholesale repurchase agreements and Federal Home Loan Bank ( FHLB ) borrowings, by year, as of September 30, 2016:

| <b>Wholesale Repurchase</b>   |                   |                        |              |
|-------------------------------|-------------------|------------------------|--------------|
| <i>(Amounts in thousands)</i> | <b>Agreements</b> | <b>FHLB Borrowings</b> | <b>Total</b> |
| 2016                          | \$ 25,000         | \$ 25,000              | \$ 50,000    |
| 2017                          |                   | 15,000                 | 15,000       |
| 2018                          |                   |                        |              |
| 2019                          | 25,000            |                        | 25,000       |
| 2020                          |                   |                        |              |
| 2021 and thereafter           |                   | 50,000                 | 50,000       |
|                               | \$ 50,000         | \$ 90,000              | \$ 140,000   |

Weighted average maturity (in years)

1.32                      2.49                      2.07

The FHLB may redeem callable advances at quarterly intervals, which could substantially shorten the advances' lives. If called, the advance may be paid in full or converted into another FHLB credit product. Prepayment of an advance may result in substantial penalties based on the differential between the contractual note and current advance rate for similar maturities. The Company pledged certain loans to secure FHLB advances and letters of credit of \$965.09 million as of September 30, 2016. Unused borrowing capacity with the FHLB totaled \$495.15 million, net of FHLB letters of credit used to collateralize public unit deposits of \$74.32 million, as of September 30, 2016. The FHLB letters of credit provide an attractive alternative to pledging securities for public unit deposits.

Subordinated debt consists of \$15.46 million of junior subordinated debentures ( Debentures ) the Company issued to the Trust in October 2003 with an interest rate of three-month London InterBank Offered Rate ( LIBOR ) plus 2.95%. The Trust purchased the Debentures through the issuance of trust preferred securities, which had substantially identical terms as the Debentures. The Debentures mature on October 8, 2033, and are callable quarterly. Net proceeds from the offering were contributed as capital to the Bank to support further growth. The Company's obligations under the Debentures and other relevant Trust agreements, in aggregate, constitute a full and unconditional guarantee of the Trust's obligations. The preferred securities issued by the Trust are not included in the Company's consolidated balance sheets; however, these securities qualify as Tier 1 capital for regulatory purposes, subject to guidelines issued by the Board of Governors of the Federal Reserve System ( Federal Reserve ). The Federal Reserve's quantitative limits did not prevent the Company from including all \$15.46 million in trust preferred securities outstanding in Tier 1 capital as of September 30, 2016, and December 31, 2015.

In addition, the Company maintains a \$15.00 million unsecured, committed line of credit with an unrelated financial institution with an interest rate of one-month LIBOR plus 2.00% and an April 2017 maturity. There was no outstanding balance on the line as of September 30, 2016, or December 31, 2015.

#### **Note 10. Derivative Instruments and Hedging Activities**

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

the Company will incur a loss because a counterparty, which may be a bank, a broker-dealer or a customer, fails to meet its contractual obligations. This risk is measured as the expected positive replacement value of contracts. Derivative contracts may be executed only with exchanges or counterparties approved by the Company's Asset/Liability Management Committee.

As of September 30, 2016, the Company's derivative instruments consisted of interest rate swaps. Generally, derivative instruments help the Company manage exposure to market risk and meet customer financing needs. Market risk represents the possibility that fluctuations in external factors such as interest rates, market-driven loan rates, prices, or other economic factors will adversely affect economic value or net interest income.

*Interest rate swaps.* The Company uses interest rate swap contracts to modify its exposure to interest rate risk caused by changes in the LIBOR curve in relation to certain designated fixed rate loans. These instruments are used to convert these fixed rate loans to an effective floating rate. If the LIBOR rate falls below the loan's stated fixed rate for a given period, the

Company will owe the floating rate payer the notional amount times the difference between LIBOR and the stated fixed rate. If LIBOR is above the stated rate for a given period, the Company will receive payments based on the notional amount times the difference between LIBOR and the stated fixed rate. The Company's interest rate swaps qualify as fair value hedging instruments; therefore, fair value changes in the derivative and hedged item attributable to the hedged risk are recognized in earnings in the same period.

The Company's interest rate swaps include a fourteen-year, \$1.20 million notional interest rate swap agreement entered into in March 2015 and a fifteen-year, \$4.37 million notional interest rate swap agreement entered into in February 2014. The swap agreements, which are accounted for as fair value hedges, and the loans hedged by the agreements are recorded at fair value. The fair value hedges were effective as of September 30, 2016.

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

|                                                      | September 30, 2016                   |                      |                           | December 31, 2015                    |                      |                           |
|------------------------------------------------------|--------------------------------------|----------------------|---------------------------|--------------------------------------|----------------------|---------------------------|
|                                                      | Notional<br>or<br>Contractual Amount | Derivative<br>Assets | Derivative<br>Liabilities | Notional<br>or<br>Contractual Amount | Derivative<br>Assets | Derivative<br>Liabilities |
| <i>(Amounts in thousands)</i>                        |                                      |                      |                           |                                      |                      |                           |
| Derivatives designated as hedges Interest rate swaps | \$ 4,944                             | \$                   | \$ 450                    | \$ 5,151                             | \$                   | \$ 251                    |
| Total derivatives                                    | \$ 4,944                             | \$                   | \$ 450                    | \$ 5,151                             | \$                   | \$ 251                    |

The following table presents the effect of derivative and hedging activity, if applicable, on the consolidated statements of income for the periods indicated:

|                                                      | Three Months Ended September 30, 2016 |       | Nine Months Ended September 30, 2015 |       | Income Statement Location  |
|------------------------------------------------------|---------------------------------------|-------|--------------------------------------|-------|----------------------------|
| (Amounts in thousands)                               | 2016                                  | 2015  | 2016                                 | 2015  |                            |
| Derivatives designated as hedges Interest rate swaps | \$ 31                                 | \$ 33 | \$ 86                                | \$ 91 | Interest and fees on loans |
| Total derivative expense                             | \$ 31                                 | \$ 33 | \$ 86                                | \$ 91 |                            |

#### Note 11. Employee Benefit Plans

The Company maintains the Supplemental Executive Retention Plan ( SERP ) for key members of senior management. The following table presents the components of the SERP's net periodic pension cost for the periods indicated:

|                               | Three Months Ended September 30, 2016 |       | Nine Months Ended September 30, 2015 |        |
|-------------------------------|---------------------------------------|-------|--------------------------------------|--------|
| <i>(Amounts in thousands)</i> | 2016                                  | 2015  | 2016                                 | 2015   |
| Service cost                  | \$ 35                                 | \$ 33 | \$ 107                               | \$ 100 |

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|                                    |        |        |        |        |
|------------------------------------|--------|--------|--------|--------|
| Interest cost                      | 79     | 71     | 237    | 211    |
| Amortization of prior service cost | 47     | 46     | 141    | 140    |
| Amortization of losses             | 5      | 2      | 14     | 5      |
| Net periodic cost                  | \$ 166 | \$ 152 | \$ 499 | \$ 456 |

The Company maintains the Directors Supplemental Retirement Plan (the Directors Plan ) for non-management directors. The following table presents the components of the Directors Plan s net periodic pension cost for the periods indicated:

|                                    | Three Months Ended September 30, |       | Nine Months Ended September 30, |        |
|------------------------------------|----------------------------------|-------|---------------------------------|--------|
|                                    | 2016                             | 2015  | 2016                            | 2015   |
| <i>(Amounts in thousands)</i>      |                                  |       |                                 |        |
| Service cost                       | \$ 11                            | \$ 12 | \$ 31                           | \$ 35  |
| Interest cost                      | 16                               | 13    | 49                              | 40     |
| Amortization of prior service cost | 10                               | 18    | 29                              | 54     |
| Amortization of losses             | 7                                | 15    | 21                              | 45     |
| Net periodic cost                  | \$ 44                            | \$ 58 | \$ 130                          | \$ 174 |

**Note 12. Accumulated Other Comprehensive Income**

The following tables present the activity in accumulated other comprehensive income ( AOCI ), net of tax, by component for the periods indicated:

| <b>Three Months Ended September 30, 2016</b>                  |                                                                 |                               |              |
|---------------------------------------------------------------|-----------------------------------------------------------------|-------------------------------|--------------|
|                                                               | <b>Unrealized Gains<br/>(Losses) on Available-<br/>for-Sale</b> |                               |              |
| <i>(Amounts in thousands)</i>                                 | <b>Securities</b>                                               | <b>Employee Benefit Plans</b> | <b>Total</b> |
| Beginning balance                                             | \$ (1,706)                                                      | \$ (1,311)                    | \$ (3,017)   |
| Other comprehensive income (loss)<br>before reclassifications | 465                                                             | (2)                           | 463          |
| Reclassified from AOCI                                        | 2,881                                                           | 43                            | 2,924        |
| Net comprehensive income                                      | 3,346                                                           | 41                            | 3,387        |
| Ending balance                                                | \$ 1,640                                                        | \$ (1,270)                    | \$ 370       |

| <b>Three Months Ended September 30, 2015</b>           |                                                                             |                                  |              |
|--------------------------------------------------------|-----------------------------------------------------------------------------|----------------------------------|--------------|
|                                                        | <b>Unrealized<br/>Gains<br/>(Losses)<br/>on<br/>Available-<br/>for-Sale</b> |                                  |              |
| <i>(Amounts in thousands)</i>                          | <b>Securities</b>                                                           | <b>Employee<br/>Benefit Plan</b> | <b>Total</b> |
| Beginning balance                                      | \$ (4,899)                                                                  | \$ (1,299)                       | \$ (6,198)   |
| Other comprehensive income before<br>reclassifications | 2,385                                                                       |                                  | 2,385        |
| Reclassified from AOCI                                 | 24                                                                          | 51                               | 75           |
| Net comprehensive income                               | 2,409                                                                       | 51                               | 2,460        |
| Ending balance                                         | \$ (2,490)                                                                  | \$ (1,248)                       | \$ (3,738)   |

| <b>Nine Months Ended September 30, 2016</b> |                                                                             |                                   |              |
|---------------------------------------------|-----------------------------------------------------------------------------|-----------------------------------|--------------|
|                                             | <b>Unrealized<br/>Gains<br/>(Losses)<br/>on<br/>Available-<br/>for-Sale</b> |                                   |              |
| <i>(Amounts in thousands)</i>               | <b>Securities</b>                                                           | <b>Employee<br/>Benefit Plans</b> | <b>Total</b> |
| Beginning balance                           | \$ (3,885)                                                                  | \$ (1,362)                        | \$ (5,247)   |
|                                             | 2,588                                                                       | (36)                              | 2,552        |



Other comprehensive income (loss)  
before reclassifications

|                        |       |     |       |
|------------------------|-------|-----|-------|
| Reclassified from AOCI | 2,937 | 128 | 3,065 |
|------------------------|-------|-----|-------|

|                          |       |    |       |
|--------------------------|-------|----|-------|
| Net comprehensive income | 5,525 | 92 | 5,617 |
|--------------------------|-------|----|-------|

|                |          |            |        |
|----------------|----------|------------|--------|
| Ending balance | \$ 1,640 | \$ (1,270) | \$ 370 |
|----------------|----------|------------|--------|

# Nine Months Ended September 30, 2015

## Unrealized Gains (Losses) on Available- for-Sale Securities

## Employee Benefit Plan

## Total

(Amounts in thousands)

|                   |            |            |            |
|-------------------|------------|------------|------------|
| Beginning balance | \$ (4,266) | \$ (1,339) | \$ (5,605) |
|-------------------|------------|------------|------------|

Other comprehensive income (loss)

|                          |       |      |       |
|--------------------------|-------|------|-------|
| before reclassifications | 1,870 | (62) | 1,808 |
|--------------------------|-------|------|-------|

|                        |      |     |    |
|------------------------|------|-----|----|
| Reclassified from AOCI | (94) | 153 | 59 |
|------------------------|------|-----|----|

|                          |       |    |       |
|--------------------------|-------|----|-------|
| Net comprehensive income | 1,776 | 91 | 1,867 |
|--------------------------|-------|----|-------|

|                |            |            |            |
|----------------|------------|------------|------------|
| Ending balance | \$ (2,490) | \$ (1,248) | \$ (3,738) |
|----------------|------------|------------|------------|

The following table presents reclassifications out of AOCI by component for the periods indicated:

| (Amounts in thousands)                     | Three Months Ended    |         | Nine Months Ended     |         | Income Statement                             |
|--------------------------------------------|-----------------------|---------|-----------------------|---------|----------------------------------------------|
|                                            | September 30,<br>2016 | 2015    | September 30,<br>2016 | 2015    | Line Item Affected                           |
| Available-for-sale securities              |                       |         |                       |         |                                              |
| Gains (losses) recognized                  | 25                    | (39)    | (53)                  | 151     | Net gain (loss) on sale of securities        |
| Credit-related OTTI recognized             | (4,635)               |         | (4,646)               |         | Net impairment losses recognized in earnings |
| Reclassified out of AOCI, before tax       | (4,610)               | (39)    | (4,699)               | 151     | Income before income taxes                   |
| Income tax effect                          | (1,729)               | (15)    | (1,762)               | 57      | Income tax expense                           |
| Reclassified out of AOCI, net of tax       | (2,881)               | (24)    | (2,937)               | 94      | Net income                                   |
| Employee benefit plans                     |                       |         |                       |         |                                              |
| Amortization of prior service cost         | (57)                  | (65)    | (170)                 | (195)   | (1)                                          |
| Amortization of net actuarial benefit cost | (12)                  | (17)    | (35)                  | (50)    | (1)                                          |
| Reclassified out of AOCI, before tax       | (69)                  | (82)    | (205)                 | (245)   | Income before income taxes                   |
| Income tax effect                          | (26)                  | (31)    | (77)                  | (92)    | Income tax expense                           |
| Reclassified out of AOCI, net of tax       | (43)                  | (51)    | (128)                 | (153)   | Net income                                   |
| Total reclassified out of AOCI, net of tax | \$ (2,924)            | \$ (75) | \$ (3,065)            | \$ (59) | Net income                                   |

(1) Amortization is included in net periodic pension cost. See Note 11, Employee Benefit Plans.

### Note 13. Fair Value

#### Financial Instruments Measured at Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The following discussion describes the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments under the valuation hierarchy.

The fair value hierarchy ranks the inputs used in measuring fair value as follows:

Level 1 Observable, unadjusted quoted prices in active markets

Level 2 Inputs other than quoted prices included in Level 1 that are directly or indirectly observable for the asset or liability

Level 3 Unobservable inputs with little or no market activity that require the Company to use reasonable inputs and assumptions

The Company uses fair value measurements to record adjustments to certain financial assets and liabilities on a recurring basis. Additionally, the Company may be required to record certain assets at fair value on a nonrecurring basis in specific circumstances, such as evidence of impairment. Methodologies used to determine fair value might be highly subjective and judgmental in nature, such as cash flow estimates, risk characteristics, credit quality measurements, and interest rates; therefore, valuations may not be precise. Since fair values are estimated as of a specific date, the amounts actually realized or paid on the settlement or maturity of these instruments may be significantly different from estimates. See Significant Accounting Policies in Note 1, Basis of Presentation, to the Condensed Consolidated Financial Statements of this report.

*Assets and Liabilities Reported at Fair Value on a Recurring Basis*

*Available-for-Sale Securities.* Securities available for sale are reported at fair value on a recurring basis. The fair value of Level 1 securities is based on quoted market prices in active markets, if available. The Company also uses Level 1 inputs to value equity securities that are traded in active markets. If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are primarily derived from or corroborated by observable market data. Level 2 securities use fair value measurements from independent pricing services obtained by the Company. These fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions. The Company's Level 2 securities include U.S. Treasury securities, single issue trust preferred securities, corporate securities, mortgage-backed securities, and certain equity securities that are not actively traded. Securities are based on Level 3 inputs when there is limited activity or less transparency to the valuation inputs. In the absence of observable or corroborated market data, internally developed estimates that incorporate market-based assumptions are used when such information is available.

Fair value models may be required when trading activity has declined significantly or does not exist, prices are not current, or pricing variations are significant. For Level 3 securities, the Company obtains the cash flow of specific securities from third parties that use modeling software to determine cash flows based on market participant data and knowledge of the structures of each individual security. The fair values of Level 3 securities are determined by applying proper market observable discount rates to the cash flow derived from third-party models. Discount rates are developed by determining credit spreads above a benchmark rate, such as LIBOR, and adding premiums for illiquidity, which are based on a comparison of initial issuance spread to LIBOR versus a financial sector curve for recently issued debt to LIBOR. Securities with increased uncertainty about the receipt of cash flows are discounted at higher rates due to the addition of a deal specific credit premium based on assumptions about the performance of the underlying collateral. Finally, internal fair value model pricing and external pricing observations are combined by assigning weights to each pricing observation. Pricing is reviewed for reasonableness based on the direction of specific markets and the general economic indicators.

*Loans Held for Investment.* Loans held for investment are reported at fair value using discounted future cash flows that apply current interest rates for loans with similar terms and borrower credit quality. Loans related to fair value hedges are recorded at fair value on a recurring basis.

*Deferred Compensation Assets and Liabilities.* Securities held for trading purposes are recorded at fair value on a recurring basis and included in other assets in the consolidated balance sheets. These securities include assets related to employee deferred compensation plans, which are generally invested in Level 1 equity securities. The liability associated with these deferred compensation plans is carried at the fair value of the obligation to the employee, which corresponds to the fair value of the invested assets.

*Derivative Assets and Liabilities.* Derivatives are recorded at fair value on a recurring basis. The Company obtains dealer quotes, Level 2 inputs, based on observable data to value derivatives.

The following tables summarize financial assets and liabilities recorded at fair value on a recurring basis, segregated by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

| (Amounts in thousands)                  | Total<br>Fair<br>Value | September 30, 2016<br>Fair Value Measurements Using |          |         |
|-----------------------------------------|------------------------|-----------------------------------------------------|----------|---------|
|                                         |                        | Level<br>1                                          | Level 2  | Level 3 |
| Available-for-sale securities           |                        |                                                     |          |         |
| U.S. Agency securities                  | \$ 1,375               | \$                                                  | \$ 1,375 | \$      |
| Municipal securities                    | 122,074                |                                                     | 122,074  |         |
| Single issue trust preferred securities | 48,520                 |                                                     | 48,520   |         |
| Corporate securities                    | 15,022                 |                                                     | 15,022   |         |
| Agency MBS                              | 33,792                 |                                                     | 33,792   |         |
| Equity securities                       | 73                     | 55                                                  | 18       |         |
| Total available-for-sale securities     | 220,856                | 55                                                  | 220,801  |         |
| Fair value loans                        | 4,464                  |                                                     | 4,464    |         |
| Deferred compensation assets            | 3,842                  | 3,842                                               |          |         |
| Deferred compensation liabilities       | 3,842                  | 3,842                                               |          |         |
| Derivative liabilities                  | 450                    |                                                     | 450      |         |



|                                         | December 31, 2015             |         |           |         |
|-----------------------------------------|-------------------------------|---------|-----------|---------|
|                                         | Fair Value Measurements Using |         |           |         |
| (Amounts in thousands)                  | Total Fair Value              | Level 1 | Level 2   | Level 3 |
| Available-for-sale securities           |                               |         |           |         |
| U.S. Agency securities                  | \$ 30,702                     | \$      | \$ 30,702 | \$      |
| Municipal securities                    | 128,678                       |         | 128,678   |         |
| Single issue trust preferred securities | 47,832                        |         | 47,832    |         |
| Corporate securities                    | 70,333                        |         | 70,333    |         |
| Certificates of deposit                 | 5,000                         |         | 5,000     |         |
| Agency MBS                              | 83,556                        |         | 83,556    |         |
| Equity securities                       | 72                            | 54      | 18        |         |
| Total available-for-sale securities     | 366,173                       | 54      | 366,119   |         |
| Fair value loans                        | 4,886                         |         | 4,886     |         |
| Deferred compensation assets            | 3,464                         | 3,464   |           |         |
| Deferred compensation liabilities       | 3,464                         | 3,464   |           |         |
| Derivative liabilities                  | 251                           |         | 251       |         |

No changes in valuation techniques or transfers into or out of Level 3 of the fair value hierarchy occurred during the three and nine months ended September 30, 2016 or 2015. If the Company determines that a valuation technique change is necessary, the change is assumed to have occurred at the end of the respective reporting period.

#### *Assets Measured at Fair Value on a Nonrecurring Basis*

**Impaired Loans.** Impaired loans are recorded at fair value on a nonrecurring basis when repayment is expected solely from the sale of the loan's collateral. Fair value is based on appraised value adjusted for customized discounting criteria, Level 3 inputs.

The Company maintains an active and robust problem credit identification system. The impairment review includes obtaining third-party collateral valuations to help management identify potential credit impairment and determine the amount of impairment to record. The Company's Special Assets staff manages and monitors all impaired loans. Internal collateral valuations are generally performed within two to four weeks of identifying the initial potential impairment. The internal valuation compares the original appraisal to current local real estate market conditions and considers experience and expected liquidation costs. The Company typically receives a third-party valuation within thirty to forty-five days of completing the internal valuation. When a third-party valuation is received, it is reviewed for reasonableness. Once the valuation is reviewed and accepted, discounts are applied to fair market value, based on, but not limited to, our historical liquidation experience for like collateral, resulting in an estimated net realizable value. The estimated net realizable value is compared to the outstanding loan balance to determine the appropriate amount of specific impairment reserve.

Specific reserves are generally recorded for impaired loans while third-party valuations are in process and for impaired loans that continue to make some form of payment. While waiting to receive the third-party appraisal, the Company regularly reviews the relationship to identify any potential adverse developments and begins the tasks necessary to gain control of the collateral and prepare it for liquidation, including, but not limited to, engagement of counsel, inspection of collateral, and continued communication with the borrower. Generally, the only difference between the current appraised value, less liquidation costs, and the carrying amount of the loan, less the specific reserve, is any downward adjustment to the appraised value that the Company deems appropriate, such as the costs to sell the property. Impaired loans that do not meet certain criteria and do not have a specific reserve have typically been written down through partial charge-offs to net realizable value. Based on prior experience, the Company rarely

returns loans to performing status after they have been partially charged off. Credits identified as impaired move quickly through the process towards ultimate resolution, except in cases involving bankruptcy and various state judicial processes that may extend the time for ultimate resolution.

*Other Real Estate Owned.* OREO is recorded at fair value on a nonrecurring basis using Level 3 inputs. The Company calculates the fair value of OREO from current or prior appraisals that have been adjusted for valuation declines, estimated selling costs, and other proprietary qualitative adjustments that are deemed necessary.

The following tables summarize assets measured at fair value on a nonrecurring basis, segregated by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

| (Amounts in thousands)      | Total<br>Fair Value | September 30, 2016<br>Fair Value Measurements Using |         |          |
|-----------------------------|---------------------|-----------------------------------------------------|---------|----------|
|                             |                     | Level 1                                             | Level 2 | Level 3  |
| Impaired loans, non-covered | \$ 6,305            | \$                                                  | \$      | \$ 6,305 |
| OREO, non-covered           | 4,002               |                                                     |         | 4,002    |
| OREO, covered               | 2,257               |                                                     |         | 2,257    |

| (Amounts in thousands)      | Total<br>Fair<br>Value | December 31, 2015<br>Fair Value Measurements Using |         |          |
|-----------------------------|------------------------|----------------------------------------------------|---------|----------|
|                             |                        | Level 1                                            | Level 2 | Level 3  |
| Impaired loans, non-covered | \$ 9,164               | \$                                                 | \$      | \$ 9,164 |
| OREO, non-covered           | 4,819                  |                                                    |         | 4,819    |
| OREO, covered               | 4,034                  |                                                    |         | 4,034    |

*Quantitative Information about Level 3 Fair Value Measurements*

The following table presents quantitative information for assets measured at fair value on a nonrecurring basis using Level 3 valuation inputs as of the dates indicated:

|                             | Valuation<br>Technique               | Unobservable<br>Input                | Discount Range (Weighted Average) |                   |
|-----------------------------|--------------------------------------|--------------------------------------|-----------------------------------|-------------------|
|                             |                                      |                                      | September 30, 2016                | December 31, 2015 |
| Impaired loans, non-covered | Discounted appraisals <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> | 3% to 47% (31%)                   | 1% to 39% (21%)   |
| OREO, non-covered           | Discounted appraisals <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> | 0% to 66% (28%)                   | 1% to 100% (33%)  |
| OREO, covered               | Discounted appraisals <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> | 0% to 89% (61%)                   | 21% to 65% (46%)  |

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

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

*Fair Value of Financial Instruments*

The Company uses various methodologies and assumptions to estimate the fair value of certain financial instruments. A description of valuation methodologies used for instruments not previously discussed is as follows:

*Cash and Cash Equivalents.* Cash and cash equivalents are reported at their carrying amount, which is considered a reasonable estimate due to the short-term nature of these instruments.

*Held-to-Maturity Securities.* Securities held to maturity are reported at fair value using quoted market prices or dealer quotes.

*FDIC Indemnification Asset.* The FDIC indemnification asset is reported at fair value using discounted future cash flows that apply current discount rates.



*Accrued Interest Receivable/Payable.* Accrued interest receivable/payable is reported at their carrying amount, which is considered a reasonable estimate due to the short-term nature of these instruments.

*Deposits and Securities Sold Under Agreements to Repurchase.* Deposits without a stated maturity, such as demand, interest-bearing demand, and savings, are reported at their carrying amount, the amount payable on demand as of the reporting date, which is considered a reasonable estimate of fair value. Deposits and repurchase agreements with fixed maturities and rates are reported at fair value using discounted future cash flows that apply interest rates available in the market for instruments with similar characteristics and maturities.

*FHLB and Other Borrowings.* FHLB and other borrowings are reported at fair value using discounted future cash flows that apply interest rates available to the Company for borrowings with similar characteristics and maturities. Trust preferred obligations are reported at fair value using current credit spreads in the market for similar issues.

*Off-Balance Sheet Instruments.* The Company believes that fair values of unfunded commitments to extend credit, standby letters of credit, and financial guarantees are not meaningful; therefore, off-balance sheet instruments are not addressed in the fair value disclosures. The Company believes it is not feasible or practical to accurately disclose the fair values of off-balance sheet instruments due to the uncertainty and difficulty in assessing the likelihood and timing of advancing available proceeds, the lack of an established market for these instruments, and the diversity in fee structures. For additional information regarding the unfunded, contractual value of off-balance sheet financial instruments see Note 14, *Litigation, Commitments and Contingencies*, to the Condensed Consolidated Financial Statements of this report.

The following tables present the carrying amounts and fair values of financial instruments, segregated by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

| <i>(Amounts in thousands)</i>                  | Carrying<br>Amount | Fair Value | September 30, 2016            |         |           |
|------------------------------------------------|--------------------|------------|-------------------------------|---------|-----------|
|                                                |                    |            | Fair Value Measurements Using |         |           |
|                                                |                    |            | Level 1                       | Level 2 | Level 3   |
| <b>Assets</b>                                  |                    |            |                               |         |           |
| Cash and cash equivalents                      | \$ 65,929          | \$ 65,929  | \$ 65,929                     | \$      | \$        |
| Securities available for sale                  | 220,856            | 220,856    | 55                            | 220,801 |           |
| Securities held to maturity                    | 72,182             | 72,607     |                               | 72,607  |           |
| Loans held for investment, net of allowance    | 1,816,751          | 1,833,791  |                               | 4,464   | 1,829,327 |
| FDIC indemnification asset                     | 14,332             | 7,226      |                               |         | 7,226     |
| Interest receivable                            | 5,498              | 5,498      |                               | 5,498   |           |
| Deferred compensation assets                   | 3,842              | 3,842      | 3,842                         |         |           |
| <b>Liabilities</b>                             |                    |            |                               |         |           |
| Demand deposits                                | 473,509            | 473,509    |                               | 473,509 |           |
| Interest-bearing demand deposits               | 339,563            | 339,563    |                               | 339,563 |           |
| Savings deposits                               | 441,724            | 441,724    |                               | 441,724 |           |
| Time deposits                                  | 527,103            | 528,183    |                               | 528,183 |           |
| Securities sold under agreements to repurchase | 118,532            | 120,070    |                               | 120,070 |           |
| Interest payable                               | 1,252              | 1,252      |                               | 1,252   |           |
| FHLB and other borrowings                      | 105,707            | 110,172    |                               | 110,172 |           |
| Derivative financial liabilities               | 450                | 450        |                               | 450     |           |
| Deferred compensation liabilities              | 3,842              | 3,842      | 3,842                         |         |           |

| <i>(Amounts in thousands)</i>               | Carrying<br>Amount | Fair Value | December 31, 2015             |         |           |
|---------------------------------------------|--------------------|------------|-------------------------------|---------|-----------|
|                                             |                    |            | Fair Value Measurements Using |         |           |
|                                             |                    |            | Level 1                       | Level 2 | Level 3   |
| <b>Assets</b>                               |                    |            |                               |         |           |
| Cash and cash equivalents                   | \$ 51,787          | \$ 51,787  | \$ 51,787                     | \$      | \$        |
| Securities available for sale               | 366,173            | 366,173    | 54                            | 366,119 |           |
| Securities held to maturity                 | 72,541             | 72,490     |                               | 72,490  |           |
| Loans held for investment, net of allowance | 1,686,308          | 1,685,061  |                               | 4,886   | 1,680,175 |
| FDIC indemnification asset                  | 20,844             | 10,753     |                               |         | 10,753    |
| Interest receivable                         | 6,007              | 6,007      |                               | 6,007   |           |

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|                                                |         |         |         |
|------------------------------------------------|---------|---------|---------|
| Deferred compensation assets                   | 3,464   | 3,464   | 3,464   |
| <b>Liabilities</b>                             |         |         |         |
| Demand deposits                                | 451,511 | 451,511 | 451,511 |
| Interest-bearing demand deposits               | 347,705 | 347,705 | 347,705 |
| Savings deposits                               | 530,585 | 530,585 | 530,585 |
| Time deposits                                  | 543,458 | 541,059 | 541,059 |
| Securities sold under agreements to repurchase | 138,614 | 140,880 | 140,880 |
| Interest payable                               | 1,260   | 1,260   | 1,260   |
| FHLB and other borrowings                      | 80,756  | 85,774  | 85,774  |
| Derivative financial liabilities               | 251     | 251     | 251     |
| Deferred compensation liabilities              | 3,464   | 3,464   | 3,464   |

**Note 14. Litigation, Commitments and Contingencies*****Litigation***

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

***Commitments and Contingencies***

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized in the balance sheets. The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments. If the other party to a financial instrument does not perform, the Company's credit loss exposure is the same as the contractual amount of the instrument. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn on, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of each customer on a case-by-case basis. Collateral may include accounts receivable, inventory, property, plant and equipment, and income producing commercial properties. The Company maintains a reserve for the risk inherent in unfunded lending commitments, which is included in other liabilities in the consolidated balance sheets.

Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending credit to customers. The amount of collateral obtained, if deemed necessary, to secure the customer's performance under certain letters of credit is based on management's credit evaluation of the customer.

The following table presents the off-balance sheet financial instruments as of the dates indicated:

| <i>(Amounts in thousands)</i>                      | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|----------------------------------------------------|---------------------------|--------------------------|
| Commitments to extend credit                       | \$ 260,416                | \$ 235,302               |
| Standby letters of credit and financial guarantees | 7,981                     | 7,765                    |
| <b>Total off-balance sheet risk</b>                | <b>268,397</b>            | <b>243,067</b>           |
| Reserve for unfunded commitments                   | \$ 326                    | \$ 326                   |

In connection with the private placement of \$15.46 million of trust preferred securities through the Trust, the Company irrevocably and unconditionally guarantees the following payments or distributions to holders of the trust preferred securities, to the extent the Trust has not made such payments or distributions and the Company has the

funds available: accrued and unpaid distributions, the redemption price, and, upon dissolution or termination of the Trust, the lesser of the liquidation amount and all accrued and unpaid distributions and the amount of assets of the Trust remaining available for distribution.

**Note 15. Earnings per Share**

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of potential common stock that could be issued by the Company. Under the treasury stock method of accounting, potential common stock may be issued for stock options, non-vested restricted stock awards, performance based stock awards, and convertible preferred stock. Diluted earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding for the period plus the number of dilutive potential common shares. The calculation of diluted earnings per common share excludes potential common shares that have an exercise price greater than the average market value of the Company's common stock because the effect would be antidilutive.

The following table presents the calculation of basic and diluted earnings per common share for the periods indicated:

| <i>(Amounts in thousands, except share and per share data)</i> | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|----------------------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                                | <b>2016</b>                                 | <b>2015</b> | <b>2016</b>                                | <b>2015</b> |
| Net income                                                     | \$ 6,383                                    | \$ 6,259    | \$ 18,722                                  | \$ 18,392   |
| Dividends on preferred stock                                   |                                             |             |                                            | 105         |
| Net income available to common shareholders                    | \$ 6,383                                    | \$ 6,259    | \$ 18,722                                  | \$ 18,287   |
| Weighted average common shares outstanding, basic              | 17,031,074                                  | 18,470,348  | 17,433,406                                 | 18,644,679  |
| Dilutive effect of potential common shares                     |                                             |             |                                            |             |
| Stock options                                                  | 38,746                                      | 26,804      | 31,856                                     | 24,938      |
| Restricted stock                                               | 13,706                                      | 3,823       | 9,949                                      | 3,091       |
| Convertible preferred stock                                    |                                             |             |                                            | 223,201     |
| Total dilutive effect of potential common shares               | 52,452                                      | 30,627      | 41,805                                     | 251,230     |
| Weighted average common shares outstanding, diluted            | 17,083,526                                  | 18,500,975  | 17,475,211                                 | 18,895,909  |
| Basic earnings per common share                                | \$ 0.37                                     | \$ 0.34     | \$ 1.07                                    | \$ 0.98     |
| Diluted earnings per common share                              | 0.37                                        | 0.34        | 1.07                                       | 0.97        |
| Antidilutive potential common shares                           |                                             |             |                                            |             |
| Stock options                                                  | 127,789                                     | 130,382     | 127,789                                    | 130,382     |
| Total potential antidilutive shares                            | 127,789                                     | 130,382     | 127,789                                    | 130,382     |

During the first quarter of 2015, the Company redeemed all outstanding shares of its 6% Series A Noncumulative Convertible Preferred Stock ( Series A Preferred Stock ). Before redemption, holders converted 12,784 shares of Series A Preferred Stock with each share convertible into 69 shares of the Company's common stock. The Company redeemed the remaining 2,367 shares for \$2.37 million along with accrued and unpaid dividends of \$9 thousand.

#### **Note 16. Subsequent Event**

On October 1, 2016, the Company sold two North Carolina offices operating as Greenpoint Insurance Group, Inc. and two Virginia offices operating under the trade name Carr & Hyde Insurance to Ascension Insurance Agency, Inc. The transaction does not impact the Company's in-branch insurance offices operating as FCIS in West Virginia and Virginia. The net impact of the sale is not material to the Company's consolidated financial statements.

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

Unless the context suggests otherwise, the terms First Community, Company, we, our, and us refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity. Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to help the reader understand our financial condition, changes in our financial condition, and our results of operations. MD&A contains forward-looking statements and should be read in conjunction with our consolidated financial statements, accompanying notes, and other financial information included in this Quarterly Report on Form 10-Q and our 2015 Annual Report on Form 10-K (the 2015 Form 10-K ).

### **Cautionary Statement Regarding Forward-Looking Statements**

We may make forward-looking statements in filings with the Securities and Exchange Commission, including this Quarterly Report on Form 10-Q and the accompanying exhibits, filings incorporated by reference, reports to our shareholders, and other communications that we make in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent our beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are based on various factors, many of which are beyond our control. The words may, could, should, would, believe, anticipate, expect, intend, plan, and other similar expressions identify forward-looking statements. The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

the strength of the U.S. 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 System;

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 about taxes, banking, securities, and insurance, and the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act;

the impact of the U.S. Department of the Treasury and federal banking regulators' continued implementation of programs to address capital and liquidity in the banking system;

further, future and proposed rules, including those that are part of the process outlined in the International Basel Committee on Banking Supervision's Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, which require banking institutions to increase levels of capital;

technological changes;

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

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

unanticipated regulatory or judicial proceedings;

changes in consumer spending and saving habits; and

our success at managing the risks involved in the foregoing.

We caution that the foregoing list of important factors is not exclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, our actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Quarterly Report on Form 10-Q and other reports we filed with the Securities and Exchange Commission. 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 changes. These cautionary statements expressly qualify all forward-looking statements that apply to our Company. See Part II, Item 1A, Risk Factors, of this report and Part I, Item 1A, Risk Factors, of our 2015 Form 10-K.

## Corporate Overview

First Community Bancshares, Inc. (the Company), a financial holding company, was founded in 1989 and incorporated under the laws of Nevada in 1997. The Company provides commercial banking products and services through its wholly owned subsidiary First Community Bank (the Bank), a Virginia-chartered banking institution founded in 1874. The Bank operates forty-five branch banking locations in Virginia, West Virginia, and North Carolina and under the trade name People's Community Bank, a Division of First Community Bank, in Tennessee. The Bank offers wealth management and investment advice through its wholly-owned subsidiary First Community Wealth Management (FCWM).



and the Bank's Trust Division, which reported combined assets under management of \$767 million as of September 30, 2016. These assets are managed under various fee-based arrangements as fiduciary or agent. The Bank provides insurance services from certain branch locations through its full-service insurance agency subsidiary First Community Insurance Services (FCIS) in Virginia and West Virginia. We reported total assets of \$2.45 billion as of September 30, 2016. Our common stock trades on the NASDAQ Global Select Market under the symbol, FCBC.

Net interest income, the difference between interest earned on assets and interest paid on liabilities, is our primary source of earnings. Fees for services, commissions on sales, and various deposit service charges supplement our net interest income. We fund our lending and investing activities primarily through the retail deposit operations of our branch banking network and, to a lesser extent, retail and wholesale repurchase agreements and Federal Home Loan Bank (FHLB) borrowings. We invest our funds primarily in loans to retail and commercial customers and various investment securities.

### **Critical Accounting Estimates**

We prepare our consolidated financial statements in accordance with generally accepted accounting principles (GAAP) in the United States and conform to general practices within the banking industry. Our financial position and results of operations require management to make judgments and estimates to develop the amounts reflected and disclosed in the consolidated financial statements. Different assumptions in the application of estimates could result in material changes to our consolidated financial position and consolidated results of operations. Estimates, assumptions, and judgments, which are periodically evaluated, are based on historical experience and other factors, including expectations of future events believed reasonable under the circumstances. These estimates are generally necessary when assets and liabilities are required to be recorded at estimated fair value, a decline in the value of an asset carried on the financial statements at fair value warrants an impairment write-down or establishment of a valuation reserve, or an asset or liability needs recorded based on the probability of occurrence of a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. Fair values and information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or, when available, are provided by third-party sources. When third-party information is not available, management estimates valuation adjustments primarily through the use of financial modeling techniques and appraisal estimates.

Our accounting policies are fundamental in understanding MD&A and the disclosures presented in Item 1, Financial Statements, of this report. Our critical accounting estimates are described in detail in the Critical Accounting Estimates section in Part II, Item 7 of our 2015 Form 10-K.

### **Recent Business Combinations**

On July 15, 2016, the Company completed the previously announced branch exchange with First Bank, North Carolina, pursuant to which the Bank exchanged a portion of its North Carolina branch network for First Bank's Virginia branch network. Under the agreements, the Bank simultaneously sold six branches in the Winston-Salem and Mooresville areas of North Carolina and acquired seven branches in Southwestern Virginia. The Company acquired total assets of \$160.69 million, including total loans of \$149.12 million, and total liabilities of \$134.39 million, including total deposits of \$134.31 million and recorded goodwill of \$2.45 million. The Company divested total deposits of \$111.02 million and total loans of \$155.34 million. The Company recorded a net gain of \$3.07 million in connection with the divestiture.

On October 1, 2016, the Company sold two North Carolina offices operating as Greenpoint Insurance Group, Inc. and two Virginia offices operating under the trade name Carr & Hyde Insurance to Ascension Insurance Agency, Inc. The transaction does not impact the Company's in-branch insurance offices operating as FCIS in West Virginia and Virginia.

## Performance Overview

Highlights of our results of operations for the three and nine months ended September 30, 2016, and financial condition as of September 30, 2016, include the following:

We completed the branch exchange with First Bank on July 15, 2016.

Net income available to common shareholders increased \$124 thousand, or 1.98%, to \$6.38 million and diluted earnings per share increased \$0.03 to \$0.37 for the third quarter of 2016 compared to the same quarter of 2015.

Net income available to common shareholders increased \$435 thousand, or 2.38%, to \$18.72 million and diluted earnings per share increased \$0.10 to \$1.07 for the first nine months of 2016 compared to the same period of 2015.

The net interest margin decreased 10 basis points to 3.95% for the third quarter of 2016, while the normalized net interest margin increased 9 basis points to 3.77% compared to the same quarter of 2015.

The net interest margin increased 9 basis points to 4.01% and normalized net interest margin increased 18 basis points to 3.77% for the first nine months of 2016 compared to the same period of 2015.

The non-covered loan portfolio experienced significant growth, increasing \$151.04 million, or 9.30%, compared to December 31, 2015, which resulted in a loan loss provision of \$755 thousand for first nine months of 2016. The provision included a reversal of \$1.35 million in loan loss provisions related to loans divested in the First Bank transaction.

The Company's book value per common share increased \$0.92 to \$19.87 compared to December 31, 2015.

Asset quality improved as non-covered delinquent loans as a percentage of total non-covered loans decreased 21 basis points to 1.51% and non-covered nonperforming assets decreased \$1.08 million compared to December 31, 2015.

The Company repurchased 171,225 common shares during the quarter resulting in 1,152,776 shares repurchased year-to-date. Since September 30, 2013, the Company has repurchased 3,928,257 shares including the redemption of preferred stock.

The Company significantly exceeds regulatory well capitalized targets as of September 30, 2016.

## Results of Operations

### Net Income

The following table presents our net income and related information for the periods indicated:

|                                               | Three Months Ended |               | Three Months Ended |          | Nine Months Ended |               | Nine Months Ended |          |
|-----------------------------------------------|--------------------|---------------|--------------------|----------|-------------------|---------------|-------------------|----------|
|                                               | September 30,      | September 30, | Increase           | % Change | September 30,     | September 30, | Increase          | % Change |
| (Amounts in thousands, except per share data) | 2016               | 2015          | (Decrease)         | % Change | 2016              | 2015          | (Decrease)        | % Change |
| Net income                                    | \$ 6,383           | \$ 6,259      | \$ 124             | 1.98%    | \$ 18,722         | \$ 18,392     | \$ 330            | 1.79%    |
| Net income available to common shareholders   | 6,383              | 6,259         | 124                | 1.98%    | 18,722            | 18,287        | 435               | 2.38%    |
| Basic earnings per common share               | 0.37               | 0.34          | 0.03               | 8.82%    | 1.07              | 0.98          | 0.09              | 9.18%    |
| Diluted earnings per common share             | 0.37               | 0.34          | 0.03               | 8.82%    | 1.07              | 0.97          | 0.10              | 10.31%   |
| Return on average assets                      | 1.03%              | 1.00%         | 0.03%              | 3.00%    | 1.01%             | 0.96%         | 0.05%             | 5.21%    |
| Return on average common equity               | 7.58%              | 7.18%         | 0.40%              | 5.57%    | 7.40%             | 7.07%         | 0.33%             | 4.67%    |

*Three-Month Comparison.* Net income increased for the third quarter of 2016 compared to the same quarter of 2015 due to a \$1.54 million decrease in the provision for loan losses and a \$462 thousand decrease in noninterest expense offset by a \$1.18 million decrease in noninterest income, a \$548 thousand decrease in net interest income, and a \$146 thousand increase in income tax.

*Nine-Month Comparison.* Net income increased for the first nine months of 2016 compared to the same period of 2015 due to a \$1.00 million decrease in the provision for loan losses, a \$995 thousand decrease in noninterest expense,

and a \$345 thousand increase in net interest income offset by a \$1.22 million decrease in noninterest income and a \$793 thousand increase in income tax.

*Net Interest Income*

Net interest income is analyzed on a fully taxable equivalent ( FTE ) basis, a non-GAAP financial measure. The FTE basis adjusts for the tax benefits of income from certain tax exempt loans and investments using the federal statutory rate of 35%. We believe FTE basis is the preferred industry measurement of net interest income and provides better comparability between taxable and tax exempt amounts. We use this non-GAAP financial measure to monitor net interest income performance and to manage the composition of our balance sheet.

The following table presents our average consolidated balance sheets, as of the dates indicated, and the net interest analysis, on a FTE basis, for the periods indicated:

|                                           | Three Months Ended September 30, |                         |                                       |                    |                         |                                       |
|-------------------------------------------|----------------------------------|-------------------------|---------------------------------------|--------------------|-------------------------|---------------------------------------|
|                                           | 2016                             |                         |                                       | 2015               |                         |                                       |
| (Amounts in thousands)                    | Average<br>Balance               | Interest <sup>(1)</sup> | Average Yield/<br>Rate <sup>(1)</sup> | Average<br>Balance | Interest <sup>(1)</sup> | Average Yield/<br>Rate <sup>(1)</sup> |
| Assets                                    |                                  |                         |                                       |                    |                         |                                       |
| Earning assets                            |                                  |                         |                                       |                    |                         |                                       |
| Loans <sup>(2)</sup>                      | \$ 1,820,899                     | \$ 21,974               | 4.80%                                 | \$ 1,675,787       | \$ 22,291               | 5.28%                                 |
| Securities available for sale             | 266,162                          | 1,941                   | 2.90%                                 | 382,099            | 2,394                   | 2.49%                                 |
| Securities held to maturity               | 72,210                           | 189                     | 1.04%                                 | 72,624             | 195                     | 1.07%                                 |
| Interest-bearing deposits                 | 19,025                           | 26                      | 0.54%                                 | 48,750             | 33                      | 0.27%                                 |
| Total earning assets                      | 2,178,296                        | 24,130                  | 4.41%                                 | 2,179,260          | 24,913                  | 4.53%                                 |
| Other assets                              | 282,310                          |                         |                                       | 305,331            |                         |                                       |
| Total assets                              | \$ 2,460,606                     |                         |                                       | \$ 2,484,591       |                         |                                       |
| Liabilities and stockholders equity       |                                  |                         |                                       |                    |                         |                                       |
| Interest-bearing deposits                 |                                  |                         |                                       |                    |                         |                                       |
| Demand deposits                           | \$ 337,893                       | \$ 60                   | 0.07%                                 | \$ 335,831         | \$ 52                   | 0.06%                                 |
| Savings deposits                          | 523,503                          | 62                      | 0.05%                                 | 532,445            | 83                      | 0.06%                                 |
| Time deposits                             | 529,344                          | 1,011                   | 0.76%                                 | 613,598            | 1,249                   | 0.81%                                 |
| Total interest-bearing deposits           | 1,390,740                        | 1,133                   | 0.32%                                 | 1,481,874          | 1,384                   | 0.37%                                 |
| Borrowings                                |                                  |                         |                                       |                    |                         |                                       |
| Federal funds purchased                   | 3,696                            | 6                       | 0.65%                                 | 7                  |                         | 0.00%                                 |
| Retail repurchase agreements              | 64,385                           | 12                      | 0.07%                                 | 72,740             | 16                      | 0.09%                                 |
| Wholesale repurchase agreements           | 50,000                           | 473                     | 3.76%                                 | 50,000             | 473                     | 3.75%                                 |
| FHLB advances and other borrowings        | 133,838                          | 876                     | 2.60%                                 | 80,985             | 806                     | 3.95%                                 |
| Total borrowings                          | 251,919                          | 1,367                   | 2.16%                                 | 203,732            | 1,295                   | 2.52%                                 |
| Total interest-bearing liabilities        | 1,642,659                        | 2,500                   | 0.61%                                 | 1,685,606          | 2,679                   | 0.63%                                 |
| Noninterest-bearing demand deposits       | 462,588                          |                         |                                       | 433,164            |                         |                                       |
| Other liabilities                         | 20,462                           |                         |                                       | 20,028             |                         |                                       |
| Total liabilities                         | 2,125,709                        |                         |                                       | 2,138,798          |                         |                                       |
| Stockholders equity                       | 334,897                          |                         |                                       | 345,793            |                         |                                       |
| Total liabilities and stockholders equity | \$ 2,460,606                     |                         |                                       | \$ 2,484,591       |                         |                                       |

|                          |           |           |
|--------------------------|-----------|-----------|
| Net interest income, FTE | \$ 21,630 | \$ 22,234 |
| Net interest rate spread | 3.80%     | 3.90%     |
| Net interest margin      | 3.95%     | 4.05%     |

- (1) Fully taxable equivalent ( FTE ) basis based on the federal statutory rate of 35%
- (2) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.

| (Amounts in thousands)                     | Nine Months Ended September 30, |                              |                                   |                 |                              |                                   |
|--------------------------------------------|---------------------------------|------------------------------|-----------------------------------|-----------------|------------------------------|-----------------------------------|
|                                            | Average Balance                 | 2016 Interest <sup>(1)</sup> | Average Yield/Rate <sup>(1)</sup> | Average Balance | 2015 Interest <sup>(1)</sup> | Average Yield/Rate <sup>(1)</sup> |
| <b>Assets</b>                              |                                 |                              |                                   |                 |                              |                                   |
| Earning assets                             |                                 |                              |                                   |                 |                              |                                   |
| Loans <sup>(2)</sup>                       | \$ 1,775,744                    | \$ 65,836                    | 4.95%                             | \$ 1,675,118    | \$ 66,107                    | 5.28%                             |
| Securities available for sale              | 318,891                         | 6,403                        | 2.68%                             | 358,690         | 7,225                        | 2.69%                             |
| Securities held to maturity                | 72,350                          | 575                          | 1.06%                             | 70,454          | 577                          | 1.09%                             |
| Interest-bearing deposits                  | 13,288                          | 55                           | 0.55%                             | 125,295         | 246                          | 0.26%                             |
| Total earning assets                       | 2,180,273                       | 72,869                       | 4.47%                             | 2,229,557       | 74,155                       | 4.45%                             |
| Other assets                               | 287,784                         |                              |                                   | 311,825         |                              |                                   |
| Total assets                               | \$ 2,468,057                    |                              |                                   | \$ 2,541,382    |                              |                                   |
| <b>Liabilities and stockholders equity</b> |                                 |                              |                                   |                 |                              |                                   |
| Interest-bearing deposits                  |                                 |                              |                                   |                 |                              |                                   |
| Demand deposits                            | \$ 339,920                      | \$ 177                       | 0.07%                             | \$ 342,639      | \$ 156                       | 0.06%                             |
| Savings deposits                           | 533,799                         | 191                          | 0.05%                             | 532,641         | 289                          | 0.07%                             |
| Time deposits                              | 527,056                         | 2,966                        | 0.75%                             | 655,314         | 4,231                        | 0.86%                             |
| Total interest-bearing deposits            | 1,400,775                       | 3,334                        | 0.32%                             | 1,530,594       | 4,676                        | 0.41%                             |
| Borrowings                                 |                                 |                              |                                   |                 |                              |                                   |
| Federal funds purchased                    | 5,393                           | 26                           | 0.64%                             | 2               |                              | 0.00%                             |
| Retail repurchase agreements               | 69,347                          | 37                           | 0.07%                             | 70,325          | 53                           | 0.10%                             |
| Wholesale repurchase agreements            | 50,000                          | 1,410                        | 3.77%                             | 50,000          | 1,405                        | 3.76%                             |
| FHLB advances and other borrowings         | 124,803                         | 2,578                        | 2.76%                             | 91,305          | 2,713                        | 3.97%                             |
| Total borrowings                           | 249,543                         | 4,051                        | 2.17%                             | 211,632         | 4,171                        | 2.64%                             |
| Total interest-bearing liabilities         | 1,650,318                       | 7,385                        | 0.60%                             | 1,742,226       | 8,847                        | 0.68%                             |
| Noninterest-bearing demand deposits        | 457,250                         |                              |                                   | 429,661         |                              |                                   |
| Other liabilities                          | 22,581                          |                              |                                   | 20,472          |                              |                                   |
| Total liabilities                          | 2,130,149                       |                              |                                   | 2,192,359       |                              |                                   |
| Stockholders equity                        | 337,908                         |                              |                                   | 349,023         |                              |                                   |
| Total liabilities and stockholders equity  | \$ 2,468,057                    |                              |                                   | \$ 2,541,382    |                              |                                   |
| Net interest income, FTE                   |                                 | \$ 65,484                    |                                   |                 | \$ 65,308                    |                                   |
| Net interest rate spread                   |                                 |                              | 3.88%                             |                 |                              | 3.77%                             |
| Net interest margin                        |                                 |                              | 4.01%                             |                 |                              | 3.92%                             |

- (1) Fully taxable equivalent ( FTE ) basis based on the federal statutory rate of 35%
- (2) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.



The following table presents the impact on FTE net interest income resulting from changes in volume (average volume times the prior year's average rate), rate (average rate times the prior year's average volume), and rate/volume (average volume times the change in average rate), for the periods indicated:

|                                              | Three Months Ended<br>September 30, 2016 Compared to<br>2015 |            |                 |          | Nine Months Ended<br>September 30, 2016 Compared to<br>2015 |            |                 |          |
|----------------------------------------------|--------------------------------------------------------------|------------|-----------------|----------|-------------------------------------------------------------|------------|-----------------|----------|
|                                              | Dollar Increase (Decrease) due to                            |            |                 |          | Dollar Increase (Decrease) due to                           |            |                 |          |
| (Amounts in thousands)                       | Volume                                                       | Rate       | Rate/<br>Volume | Total    | Volume                                                      | Rate       | Rate/<br>Volume | Total    |
| Interest earned on <sup>(1)</sup>            |                                                              |            |                 |          |                                                             |            |                 |          |
| Loans <sup>(2)</sup>                         | \$ 5,733                                                     | \$ (5,978) | \$ (72)         | \$ (317) | \$ 3,971                                                    | \$ (4,063) | \$ (179)        | \$ (271) |
| Securities available-for-sale                | (2,157)                                                      | 1,188      | 516             | (453)    | (802)                                                       | (30)       | 10              | (822)    |
| Securities held-to-maturity                  | (3)                                                          | (13)       | 10              | (6)      | 16                                                          | (18)       |                 | (2)      |
| Interest-bearing deposits with other banks   | (60)                                                         | 100        | (47)            | (7)      | (220)                                                       | 272        | (243)           | (191)    |
| Total interest earning assets                | 3,513                                                        | (4,703)    | 407             | (783)    | 2,965                                                       | (3,839)    | (412)           | (1,286)  |
| Interest paid on <sup>(1)</sup>              |                                                              |            |                 |          |                                                             |            |                 |          |
| Demand deposits                              | 1                                                            | 23         | (16)            | 8        | (1)                                                         | 22         |                 | 21       |
| Savings deposits                             | (4)                                                          | (59)       | 42              | (21)     | 1                                                           | (99)       |                 | (98)     |
| Time deposits                                | (509)                                                        | (219)      | 490             | (238)    | (828)                                                       | (547)      | 110             | (1,265)  |
| Federal funds purchased                      |                                                              |            | 6               | 6        |                                                             |            | 26              | 26       |
| Retail repurchase agreements                 | (5)                                                          | (7)        | 8               | (4)      | (1)                                                         | (16)       | 1               | (16)     |
| Wholesale repurchase agreements              |                                                              | 4          | (4)             |          |                                                             | 4          | 1               | 5        |
| FHLB advances and other borrowings           | 1,562                                                        | (815)      | (677)           | 70       | 995                                                         | (829)      | (301)           | (135)    |
| Total interest-bearing liabilities           | 1,045                                                        | (1,073)    | (151)           | (179)    | 166                                                         | (1,465)    | (163)           | (1,462)  |
| Change in net interest income <sup>(1)</sup> | \$ 2,468                                                     | \$ (3,630) | \$ 558          | \$ (604) | \$ 2,799                                                    | \$ (2,374) | \$ (249)        | \$ 176   |

(1) FTE basis based on the federal statutory rate of 35%

(2) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.

The following table reconciles net interest income, as presented in our consolidated statements of income, and net interest income on a FTE basis, for the periods indicated:

|                               | Three Months Ended September 30, |           | Nine Months Ended September 30, |           |
|-------------------------------|----------------------------------|-----------|---------------------------------|-----------|
| (Amounts in thousands)        | 2016                             | 2015      | 2016                            | 2015      |
| Net interest income, GAAP     | \$ 21,121                        | \$ 21,669 | \$ 63,923                       | \$ 63,578 |
| FTE adjustment <sup>(1)</sup> | 509                              | 565       | 1,561                           | 1,730     |

|                                         |           |           |           |           |
|-----------------------------------------|-----------|-----------|-----------|-----------|
| Net interest income, FTE <sup>(1)</sup> | \$ 21,630 | \$ 22,234 | \$ 65,484 | \$ 65,308 |
|-----------------------------------------|-----------|-----------|-----------|-----------|

(1) FTE basis based on the federal statutory rate of 35%

The interest earned and the average yield on loans include accretion income from acquired loan portfolios. The following table presents our average consolidated balance sheets, as of the dates indicated, and net interest analysis, on a FTE basis excluding the impact of non-cash purchase accounting accretion, for the periods indicated:

| <i>(Amounts in thousands)</i>                             | <b>Three Months Ended September 30,</b> |                           |                               |                           |
|-----------------------------------------------------------|-----------------------------------------|---------------------------|-------------------------------|---------------------------|
|                                                           | <b>2016</b>                             | <b>Average Yield/</b>     | <b>2015</b>                   | <b>Average Yield/</b>     |
|                                                           | <b>Interest<sup>(1)</sup></b>           | <b>Rate<sup>(1)</sup></b> | <b>Interest<sup>(1)</sup></b> | <b>Rate<sup>(1)</sup></b> |
| <b>Earning assets</b>                                     |                                         |                           |                               |                           |
| Loans <sup>(2)</sup>                                      | \$ 21,974                               | 4.80%                     | \$ 22,291                     | 5.28%                     |
| Accretion income                                          | 1,683                                   |                           | 2,930                         |                           |
| Less: cash accretion income                               | 699                                     |                           | 903                           |                           |
| <b>Non-cash accretion income</b>                          | <b>984</b>                              |                           | <b>2,027</b>                  |                           |
| Loans, normalized <sup>(3)</sup>                          | 20,990                                  | 4.59%                     | 20,264                        | 4.80%                     |
| Other earning assets                                      | 2,156                                   | 2.40%                     | 2,622                         | 2.07%                     |
| <b>Total earning assets</b>                               | <b>23,146</b>                           | <b>4.23%</b>              | <b>22,886</b>                 | <b>4.17%</b>              |
| <b>Total interest-bearing liabilities</b>                 | <b>2,500</b>                            | <b>0.61%</b>              | <b>2,679</b>                  | <b>0.63%</b>              |
| <b>Net interest income, FTE<sup>(3)</sup></b>             | <b>\$ 20,646</b>                        |                           | <b>\$ 20,207</b>              |                           |
| <b>Net interest rate spread, normalized<sup>(3)</sup></b> |                                         | <b>3.62%</b>              |                               | <b>3.54%</b>              |
| <b>Net interest margin, normalized<sup>(3)</sup></b>      |                                         | <b>3.77%</b>              |                               | <b>3.68%</b>              |

(1) FTE basis based on the federal statutory rate of 35%

(2) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.

(3) Normalized totals are non-GAAP financial measures that exclude non-cash loan interest accretion related to PCI loans.

| <i>(Amounts in thousands)</i>    | <b>Nine Months Ended September 30,</b> |                           |                               |                           |
|----------------------------------|----------------------------------------|---------------------------|-------------------------------|---------------------------|
|                                  | <b>2016</b>                            | <b>Average Yield/</b>     | <b>2015</b>                   | <b>Average Yield/</b>     |
|                                  | <b>Interest<sup>(1)</sup></b>          | <b>Rate<sup>(1)</sup></b> | <b>Interest<sup>(1)</sup></b> | <b>Rate<sup>(1)</sup></b> |
| <b>Earning assets</b>            |                                        |                           |                               |                           |
| Loans <sup>(2)</sup>             | \$ 65,836                              | 4.95%                     | \$ 66,107                     | 5.28%                     |
| Accretion income                 | 6,183                                  |                           | 8,765                         |                           |
| Less: cash accretion income      | 2,290                                  |                           | 3,326                         |                           |
| <b>Non-cash accretion income</b> | <b>3,893</b>                           |                           | <b>5,439</b>                  |                           |
| Loans, normalized <sup>(3)</sup> | 61,943                                 | 4.66%                     | 60,668                        | 4.84%                     |

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|                                                     |           |       |           |       |
|-----------------------------------------------------|-----------|-------|-----------|-------|
| Other earning assets                                | 7,033     | 2.32% | 8,048     | 1.94% |
| Total earning assets                                | 68,976    | 4.23% | 68,716    | 4.12% |
| Total interest-bearing liabilities                  | 7,385     | 0.60% | 8,847     | 0.68% |
| Net interest income, FTE <sup>(3)</sup>             | \$ 61,591 |       | \$ 59,869 |       |
| Net interest rate spread, normalized <sup>(3)</sup> |           | 3.63% |           | 3.44% |
| Net interest margin, normalized <sup>(3)</sup>      |           | 3.77% |           | 3.59% |

(1) FTE basis based on the federal statutory rate of 35%

(2) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.

(3) Normalized totals are non-GAAP financial measures that exclude non-cash loan interest accretion related to PCI loans.

*Three-Month Comparison.* Net interest income comprised 78.18% of total net interest and noninterest income for the third quarter of 2016 compared to 75.39% for the same quarter of 2015. Net interest income on a FTE basis decreased \$603 thousand, or 2.71%, and net interest income on a GAAP basis decreased \$548 thousand, or 2.53%, for the third quarter of 2016 compared to the same quarter of 2015. Normalized net interest income on a FTE basis is a non-GAAP measure that excludes non-cash loan accretion income related to purchased credit impaired ( PCI ) loans. The normalized net interest margin increased 9 basis points compared to a decrease of 10 basis points on a GAAP basis for the third quarter of 2016 compared to the same quarter of 2015. The normalized net interest spread increased 8 basis points compared to a decrease of 11 basis points on a GAAP basis.

Average earning assets decreased \$964 thousand, or 0.04%, during the third quarter of 2016 compared to the same quarter of 2015 primarily due to a decrease in securities available for sale offset by loan growth. The normalized yield on earning assets increased 6 basis points compared to a decrease of 13 basis points on a GAAP basis. Average loans increased \$145.11 million, or 8.66%, during the third quarter of 2016 compared to the same quarter of 2015 and the average loan to deposit ratio increased to 98.25% from 87.51%. The normalized yield on loans decreased 21 basis points compared to a decrease of 48 basis points on a GAAP basis. Non-cash accretion income decreased \$1.04 million, or 51.46%, during the third quarter of 2016 compared to the same quarter of 2015. We expect accretion income to decline in future periods due to continued acquired portfolio attrition.

Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, decreased \$42.95 million, or 2.55%, during the third quarter of 2016 compared to the same quarter of 2015 primarily due to the decline in average interest-bearing time deposit balances. The yield on interest-bearing liabilities decreased 2 basis points, which was largely due to a decrease in the average balance and rate of time deposits. Average interest-bearing deposits decreased \$91.13 million, or 6.15%, which was driven by an \$84.25 million, or 13.73%, decrease in average time deposits and an \$8.94 million, or 1.68%, decrease in savings deposits, which include money market and savings accounts, offset by a \$2.06 million, or 0.61%, increase in interest-bearing demand deposits. Average borrowings increased \$48.19 million, or 23.65%, which was driven by a \$52.85 million, or 65.26%, increase in average FHLB advances and other borrowings.

*Nine-Month Comparison.* Net interest income comprised 75.42% of total net interest and noninterest income for the first nine months of 2016 compared to 74.25% for the same period of 2015. Net interest income on a FTE basis increased \$176 thousand, or 0.27%, and net interest income on a GAAP basis increased \$345 thousand, or 0.54%, for the first nine months of 2016 compared to the same period of 2015. The normalized net interest margin increased 18 basis points compared to an increase of 9 basis points for the first nine months of 2016 compared to the same period of 2015. The normalized net interest spread increased 19 basis points compared to an increase of 10 basis points on a GAAP basis.

Average earning assets decreased \$49.28 million, or 2.21%, during the first nine months of 2016 compared to the same period of 2015 primarily due to decreases in interest-bearing deposits with other banks and securities available for sale offset by loan growth. The normalized yield on earning assets increased 11 basis points compared to an increase of 2 basis points on a GAAP basis. Average loans increased \$100.63 million, or 6.01%, during the first nine months of 2016 compared to the same period of 2015 and the average loan to deposit ratio increased to 95.57% from 85.45%. The normalized yield on loans decreased 18 basis points compared to a decrease of 33 basis points on a GAAP basis. Non-cash accretion income decreased \$1.55 million, or 28.42%, during the first nine months of 2016 compared to the same period of 2015.

Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, decreased \$91.91 million, or 5.28%, during the first nine months of 2016 compared to the same period of 2015 primarily due to the decline in average interest-bearing time deposit balances. The yield on interest-bearing liabilities decreased 8 basis points, which was largely due to a decrease in the average balance and rate of time deposits. Average interest-bearing deposits decreased \$129.82 million, or 8.48%, which was driven by a \$128.26 million, or 19.57%, decrease in average time deposits and a \$2.72 million, or 0.79%, decrease in interest-bearing demand deposits offset by a \$1.16 million, or 0.22%, increase in savings deposits. Average borrowings increased \$37.91 million, or 17.91%, which was driven by a \$33.50 million, or 36.69%, increase in average FHLB advances and other borrowings.

#### *Provision for Loan Losses*

*Three-Month Comparison.* The provision for loan losses is added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level management determines necessary to absorb probable losses in the existing loan portfolio. The provision charged to operations decreased \$1.54 million to reflect a recovery of \$1.15

million during the third quarter of 2016 compared to the same quarter of 2015, which included a \$1.55 million decrease in the non-PCI provision and a \$20 thousand increase in the PCI provision resulting in no PCI provision as of September 30, 2016. The recovery of loan losses included the reversal of provisions totaling \$1.35 million attributed to loans divested in the First Bank transaction.

*Nine-Month Comparison.* The provision charged to operations decreased \$1.00 million during the first nine months of 2016 compared to the same period of 2015, which included a \$970 thousand increase in the non-PCI provision and a \$31 thousand decrease in the PCI provision resulting in a PCI recovery of \$41 thousand. The provision charged to operations included a \$1 thousand benefit attributed to the Federal Deposit Insurance Corporation ( FDIC ) indemnification asset to reflect the indemnified portion of the post-acquisition exposure during the first nine months of 2016 compared to a \$29 thousand benefit during the same period of 2015. See Allowance for Loan Losses in the Financial Condition section below.

*Noninterest Income*

The following table presents the components of, and changes in, noninterest income for the periods indicated:

|                                              | Three Months Ended |          | Three Months Ended |          | Nine Months Ended |           | Nine Months Ended |          |
|----------------------------------------------|--------------------|----------|--------------------|----------|-------------------|-----------|-------------------|----------|
|                                              | September 30,      |          | Increase           |          | September 30,     |           | Increase          |          |
| (Amounts in thousands)                       | 2016               | 2015     | (Decrease)         | % Change | 2016              | 2015      | (Decrease)        | % Change |
| Wealth management                            | \$ 653             | \$ 790   | \$ (137)           | -17.34%  | \$ 2,147          | \$ 2,231  | \$ (84)           | -3.77%   |
| Service charges on deposits                  | 3,494              | 3,744    | (250)              | -6.68%   | 10,146            | 10,154    | (8)               | -0.08%   |
| Other service charges and fees               | 2,024              | 1,974    | 50                 | 2.53%    | 6,088             | 5,987     | 101               | 1.69%    |
| Insurance commissions                        | 1,592              | 1,650    | (58)               | -3.52%   | 5,383             | 5,336     | 47                | 0.88%    |
| Net impairment losses recognized in earnings | (4,635)            |          | (4,635)            |          | (4,646)           |           | (4,646)           |          |
| Net gain (loss) on sale of securities        | 25                 | (39)     | 64                 | -164.10% | (53)              | 151       | (204)             | -135.10% |
| Net FDIC indemnification asset amortization  | (1,369)            | (1,768)  | 399                | -22.57%  | (3,856)           | (5,179)   | 1,323             | -25.55%  |
| Net gain on divestiture                      | 3,065              |          | 3,065              |          | 3,065             |           | 3,065             |          |
| Other operating income                       | 1,046              | 723      | 323                | 44.67%   | 2,554             | 3,367     | (813)             | -24.15%  |
| Total noninterest income                     | \$ 5,895           | \$ 7,074 | \$ (1,179)         | -16.67%  | \$ 20,828         | \$ 22,047 | \$ (1,219)        | -5.53%   |

*Three-Month Comparison.* Noninterest income comprised 21.82% of total net interest and noninterest income for the third quarter of 2016 compared to 24.61% for the same quarter of 2015. Noninterest income decreased \$1.18 million, or 16.67%, for the third quarter of 2016 compared to the same quarter of 2015. The decrease in wealth management revenues, which include fees and commissions for trust and investment advisory services, was due to both FCWM and the Trust Division. Service charges on deposits and other service charges and fees decreased primarily from a decrease in service charges on checking accounts. Insurance commissions decreased largely due to a decrease in commissions from the sale of property and casualty policies. We realized net impairment losses of \$4.64 million related to certain debt securities and a net gain of \$25 thousand on the sale of securities during the third quarter of 2016. See Note 3,

Investment Securities, to the Condensed Consolidated Financial Statements in Item 1 of this report. Net negative amortization related to the FDIC indemnification asset decreased as a result of improved loss estimates and payoffs in the covered loan portfolio associated with the acquisition of Waccamaw Bank ( Waccamaw ). We realized a net gain on the divestiture of six bank branches to First Bank. See Note 2, Acquisitions and Divestitures, to the Condensed Consolidated Financial Statements in Item 1 of this report. Other operating income increased primarily due to legal settlements received.

Excluding the impact from impairment losses, sales of securities and branches, net FDIC indemnification asset amortization, and net gain on divestiture, noninterest income decreased \$149 thousand, or 1.98%, to \$8.73 million for the third quarter of 2016, from \$8.88 million for the same quarter of 2015.

*Nine-Month Comparison.* Noninterest income comprised 24.58% of total net interest and noninterest income for the first nine months of 2016 compared to 25.75% for the same period of 2015. Noninterest income decreased \$1.22 million, or 5.53%, for the first nine months of 2016 compared to the same period of 2015. The decrease in wealth management revenues was due to both FCWM and the Trust Division. Service charges on deposits and other service

charges and fees increased primarily from an increase in referral fees, credit card income, and interchange income. Insurance commissions increased largely due to an increase in commissions from the sale of life and health policies. We realized net impairment losses of \$4.65 million related to certain debt and equity securities and a net loss of \$53 thousand on the sale of securities during the first nine months of 2016. See Note 3, Investment Securities, to the Condensed Consolidated Financial Statements in Item 1 of this report. Net negative amortization related to the FDIC indemnification asset decreased as a result of improved loss estimates and payoffs in the covered loan portfolio associated with the acquisition of Waccamaw. We realized a net gain on the divestiture of six bank branches to First Bank. See Note 2, Acquisitions and Divestitures, to the Condensed Consolidated Financial Statements in Item 1 of this report. Other operating income decreased primarily due to a \$1.14 million net death benefit from the maturity of a life insurance policy recognized during the second quarter of 2015 offset by a gain on the sale of closed branches and legal settlements received.

Excluding the impact from impairment losses, sales of securities and branches, net FDIC indemnification asset amortization, net gain on divestiture, and the net death benefit recognized during the second quarter of 2015, noninterest income decreased \$55 thousand, or 0.21%, to \$25.88 million for the first nine months of 2016, from \$25.93 million for the same period of 2015.



*Noninterest Expense*

The following table presents the components of, and changes in, noninterest expense for the periods indicated:

| (Amounts in thousands)                       | Three Months Ended |                  | Three Months Ended  |               | Nine Months Ended  |                  | Nine Months Ended   |               |
|----------------------------------------------|--------------------|------------------|---------------------|---------------|--------------------|------------------|---------------------|---------------|
|                                              | September 30, 2016 | 2015             | Increase (Decrease) | % Change      | September 30, 2016 | 2015             | Increase (Decrease) | % Change      |
| Salaries and employee benefits               | \$ 9,828           | \$ 9,971         | \$ (143)            | -1.43%        | \$ 30,501          | \$ 29,357        | \$ 1,144            | 3.90%         |
| Occupancy expense                            | 1,249              | 1,443            | (194)               | -13.44%       | 4,139              | 4,404            | (265)               | -6.02%        |
| Furniture and equipment expense              | 1,066              | 1,259            | (193)               | -15.33%       | 3,271              | 3,854            | (583)               | -15.13%       |
| Amortization of intangibles                  | 316                | 281              | 35                  | 12.46%        | 871                | 837              | 34                  | 4.06%         |
| FDIC premiums and assessments                | 363                | 377              | (14)                | -3.71%        | 1,109              | 1,181            | (72)                | -6.10%        |
| FHLB debt prepayment fees                    |                    |                  |                     |               |                    | 1,702            | (1,702)             | -100.00%      |
| Merger, acquisition, and divestiture expense | 226                |                  | 226                 |               | 675                | 86               | 589                 | 684.88%       |
| Other operating expense                      | 5,509              | 5,688            | (179)               | -3.15%        | 15,527             | 15,667           | (140)               | -0.89%        |
| <b>Total noninterest expense</b>             | <b>\$ 18,557</b>   | <b>\$ 19,019</b> | <b>\$ (462)</b>     | <b>-2.43%</b> | <b>\$ 56,093</b>   | <b>\$ 57,088</b> | <b>\$ (995)</b>     | <b>-1.74%</b> |

*Three-Month Comparison.* Noninterest expense decreased \$462 thousand, or 2.43%, for the third quarter of 2016 compared to the same quarter of 2015. Full-time equivalent employees, calculated using the number of hours worked, decreased to 624 as of September 30, 2016, from 679 as of September 30, 2015, primarily due to personnel restructuring as a result of the First Bank transaction, the sale of an insurance agency in 2015, and discontinuing secondary mortgage operations. Occupancy, furniture, and equipment expense decreased \$387 thousand, or 14.32%, for the third quarter of 2016 compared to the same quarter of 2015 due to branch closures and divestitures. We incurred expenses totaling \$226 thousand related to the branch exchange with First Bank during the third quarter of 2016. The decrease in other operating expense was primarily due to a \$943 thousand decrease in the net loss on sales and expenses related to other real estate owned ( OREO ) to \$278 thousand compared to the same quarter of 2015. The decrease was offset by a \$381 thousand increase in legal fees and a \$236 thousand increase in consulting fees.

*Nine-Month Comparison.* Noninterest expense decreased \$995 thousand, or 1.74%, for the first nine months of 2016 compared to the same period of 2015. The decrease was largely due to the prepayment of \$25 million of a FHLB convertible advance during the second quarter of 2015, which resulted in a prepayment penalty of \$1.70 million. Occupancy, furniture, and equipment expense decreased \$848 thousand, or 10.27%, for the first nine months of 2016 compared to the same period of 2015 due to branch closures and divestitures. We incurred expenses totaling \$675 thousand related to the First Bank branch exchange during the first nine months of 2016. The decrease in other operating expense was primarily due to a \$727 thousand decrease in the net loss on sales and expenses related to OREO to \$1.24 million compared to the same period of 2015. The decrease was offset by a \$450 thousand increase in consulting fees and a \$413 thousand increase in legal fees.

*Income Tax Expense*

*Three-Month Comparison.* The Company's effective tax rate, income tax as a percent 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 generally include interest income on municipal securities and increases in the cash surrender value of life insurance policies, which are both exempt from federal income tax. Income tax expense increased \$146 thousand, or 4.73%, and the effective rate increased 59 basis points to 33.60% for the third quarter of 2016 compared to the same quarter of 2015. The increase in the effective rate was largely due to an increase in taxable revenues as a percent of operating earnings.

*Nine-Month Comparison.* Income tax expense increased \$793 thousand, or 9.45%, and the effective rate increased 158 basis points to 32.90% for the first nine months of 2016 compared to the same period of 2015. The increase in the effective rate was largely due to an increase in taxable revenues as a percent of operating earnings.

### ***Financial Condition***

Total assets as of September 30, 2016, decreased \$12.00 million, or 0.49%, to \$2.45 billion from \$2.46 billion as of December 31, 2015. Total liabilities as of September 30, 2016, decreased \$6.52 million, or 0.31%, to \$2.11 billion from \$2.12 billion as of December 31, 2015.

Total stockholders' equity as of September 30, 2016, decreased \$5.48 million, or 1.60%, to \$337.54 million from \$343.02 million as of December 31, 2015. The change in stockholders' equity was largely due to the repurchase of 1,152,776 shares

of our common stock totaling \$23.09 million, net income of \$18.72 million, dividends declared on our common stock of \$7.68 million, and an increase in other comprehensive income of \$5.62 million. Our book value per common share increased \$0.92, or 4.85%, to \$19.87 as of September 30, 2016, from \$18.95 as of December 31, 2015.

#### *Cash and Cash Equivalents*

Cash and cash equivalents as of September 30, 2016, increased \$14.14 million, or 27.31%, compared to December 31, 2015, primarily due to the sale of investment securities and the branch exchange transaction. Interest-bearing deposits in banks are primarily comprised of excess liquidity kept at correspondent banks bearing overnight market rates.

#### *Investment Securities*

Our investment securities are used to generate interest income through the employment of excess funds, to provide liquidity, to fund loan demand or deposit liquidation, and to pledge as collateral where required. The composition of our investment portfolio changes from time to time as we consider our liquidity needs, interest rate expectations, asset/liability management strategies, and capital requirements.

Available-for-sale securities as of September 30, 2016, decreased \$145.32 million, or 39.69%, compared to December 31, 2015, primarily due to the sale of certain corporate securities, mortgage-backed Agency securities, and U.S. Agency securities. The market value of securities available for sale as a percentage of amortized cost was 101.20% as of September 30, 2016, compared to 98.33% as of December 31, 2015.

Held-to-maturity securities as of September 30, 2016, decreased \$359 thousand, or 0.49%, compared to December 31, 2015. The market value of securities held to maturity as a percentage of amortized cost was 100.59% as of September 30, 2016, compared to 99.93% as of December 31, 2015.

Investment securities are reviewed quarterly for possible other-than-temporary impairment ( OTTI ) charges. Due to our change in intent to hold to recovery, we recognized OTTI charges in earnings associated with debt securities of \$4.64 million during the three and nine months ended September 30, 2016. We selected specific trust preferred securities in our portfolio to sell that would increase cash reserves, reduce exposure to the financial industry, and reduce credit concentrations with two issuers. We recognized no OTTI charges in earnings associated with debt securities during the three and nine months ended September 30, 2015. We recognized no OTTI charges in earnings associated with certain equity securities during the three months ended September 30, 2016, and \$11 thousand during the nine months ended September 30, 2016. We recognized no OTTI charges in earnings associated with equity securities during the three and nine months ended September 30, 2015. See Note 3, Investment Securities, to the Condensed Consolidated Financial Statements in Item 1 of this report.

#### *Loans Held for Investment*

Loans held for investment, our largest component of interest income, are grouped into commercial, consumer real estate, and consumer and other loan segments. Each segment is divided into various loan classes based on collateral or purpose. Certain loans acquired in FDIC-assisted transactions are covered under loss share agreements ( covered loans ). Total loans held for investment, net of unearned income, as of September 30, 2016, increased \$129.84 million, or 7.61%, compared to December 31, 2015, due to a \$151.04 million, or 9.30%, increase in non-covered loans, which was driven by demand in the non-farm, non-residential real estate segment of the loan portfolio. The increase was offset by a \$21.20 million, or 25.53%, decrease in covered loans due to continued runoff in the covered Waccamaw

portfolio. See Note 4, Loans, to the Condensed Consolidated Financial Statements in Item 1 of this report.

The following table presents loans, net of unearned income, with non-covered loans disaggregated by class as of the periods indicated:

| <i>(Amounts in thousands)</i>                                         | <b>September 30, 2016</b> |                | <b>December 31, 2015</b> |                | <b>September 30, 2015</b> |                |
|-----------------------------------------------------------------------|---------------------------|----------------|--------------------------|----------------|---------------------------|----------------|
|                                                                       | <b>Amount</b>             | <b>Percent</b> | <b>Amount</b>            | <b>Percent</b> | <b>Amount</b>             | <b>Percent</b> |
| Non-covered loans held for investment                                 |                           |                |                          |                |                           |                |
| Commercial loans                                                      |                           |                |                          |                |                           |                |
| Construction, development, and other land                             | \$ 49,799                 | 2.71%          | \$ 48,896                | 2.86%          | \$ 45,930                 | 2.72%          |
| Commercial and industrial                                             | 90,362                    | 4.92%          | 88,903                   | 5.21%          | 85,319                    | 5.05%          |
| Multi-family residential                                              | 127,468                   | 6.94%          | 95,026                   | 5.57%          | 93,356                    | 5.52%          |
| Single family non-owner occupied                                      | 144,023                   | 7.84%          | 149,351                  | 8.75%          | 144,725                   | 8.56%          |
| Non-farm, non-residential                                             | 596,015                   | 32.46%         | 485,460                  | 28.45%         | 479,297                   | 28.35%         |
| Agricultural                                                          | 5,786                     | 0.32%          | 2,911                    | 0.17%          | 2,414                     | 0.14%          |
| Farmland                                                              | 31,974                    | 1.74%          | 27,540                   | 1.61%          | 27,135                    | 1.61%          |
| Total commercial loans                                                | 1,045,427                 | 56.93%         | 898,087                  | 52.62%         | 878,176                   | 51.95%         |
| Consumer real estate loans                                            |                           |                |                          |                |                           |                |
| Home equity lines                                                     | 108,108                   | 5.89%          | 107,367                  | 6.29%          | 107,655                   | 6.37%          |
| Single family owner occupied                                          | 497,695                   | 27.10%         | 495,209                  | 29.02%         | 492,157                   | 29.11%         |
| Owner occupied construction                                           | 43,925                    | 2.39%          | 43,505                   | 2.55%          | 40,141                    | 2.37%          |
| Total consumer real estate loans                                      | 649,728                   | 35.38%         | 646,081                  | 37.86%         | 639,953                   | 37.85%         |
| Consumer and other loans                                              |                           |                |                          |                |                           |                |
| Consumer loans                                                        | 76,363                    | 4.16%          | 72,000                   | 4.22%          | 75,084                    | 4.44%          |
| Other                                                                 | 3,029                     | 0.16%          | 7,338                    | 0.43%          | 7,058                     | 0.42%          |
| Total consumer and other loans                                        | 79,392                    | 4.32%          | 79,338                   | 4.65%          | 82,142                    | 4.86%          |
| Total non-covered loans                                               | 1,774,547                 | 96.63%         | 1,623,506                | 95.13%         | 1,600,271                 | 94.66%         |
| Total covered loans                                                   | 61,837                    | 3.37%          | 83,035                   | 4.87%          | 90,203                    | 5.34%          |
| Total loans held for investment, net unearned income                  | 1,836,384                 | 100.00%        | 1,706,541                | 100.00%        | 1,690,474                 | 100.00%        |
| Less: allowance for loan losses                                       | 19,633                    |                | 20,233                   |                | 20,127                    |                |
| Total loans held for investment, net of unearned income and allowance | \$ 1,816,751              |                | \$ 1,686,308             |                | \$ 1,670,347              |                |
| Loans held for sale                                                   | \$                        |                | \$                       |                | \$ 523                    |                |

The following table presents covered loans disaggregated by class as of the periods indicated:

|                                           | September 30,<br>2016 |                | December 31,<br>2015 |                | September 30,<br>2015 |                |
|-------------------------------------------|-----------------------|----------------|----------------------|----------------|-----------------------|----------------|
| (Amounts in thousands)                    | Amount                | Percent        | Amount               | Percent        | Amount                | Percent        |
| <b>Commercial loans</b>                   |                       |                |                      |                |                       |                |
| Construction, development, and other land | \$ 4,699              | 7.60%          | \$ 6,303             | 7.59%          | \$ 7,573              | 8.40%          |
| Commercial and industrial                 | 941                   | 1.52%          | 1,170                | 1.41%          | 1,326                 | 1.47%          |
| Multi-family residential                  | 43                    | 0.07%          | 640                  | 0.77%          | 699                   | 0.77%          |
| Single family non-owner occupied          | 1,328                 | 2.15%          | 2,674                | 3.22%          | 2,899                 | 3.21%          |
| Non-farm, non-residential                 | 8,312                 | 13.44%         | 14,065               | 16.94%         | 15,712                | 17.42%         |
| Agricultural                              | 26                    | 0.04%          | 34                   | 0.04%          | 35                    | 0.04%          |
| Farmland                                  | 412                   | 0.67%          | 643                  | 0.77%          | 656                   | 0.73%          |
| <b>Total commercial loans</b>             | <b>15,761</b>         | <b>25.49%</b>  | <b>25,529</b>        | <b>30.74%</b>  | <b>28,900</b>         | <b>32.04%</b>  |
| <b>Consumer real estate loans</b>         |                       |                |                      |                |                       |                |
| Home equity lines                         | 38,737                | 62.64%         | 48,565               | 58.49%         | 51,205                | 56.77%         |
| Single family owner occupied              | 7,058                 | 11.41%         | 8,595                | 10.35%         | 9,736                 | 10.79%         |
| Owner occupied construction               | 201                   | 0.33%          | 262                  | 0.32%          | 278                   | 0.31%          |
| <b>Total consumer real estate loans</b>   | <b>45,996</b>         | <b>74.38%</b>  | <b>57,422</b>        | <b>69.16%</b>  | <b>61,219</b>         | <b>67.87%</b>  |
| <b>Consumer and other loans</b>           |                       |                |                      |                |                       |                |
| Consumer loans                            | 80                    | 0.13%          | 84                   | 0.10%          | 84                    | 0.09%          |
| <b>Total covered loans</b>                | <b>\$ 61,837</b>      | <b>100.00%</b> | <b>\$ 83,035</b>     | <b>100.00%</b> | <b>\$ 90,203</b>      | <b>100.00%</b> |

#### *Risk Elements*

We seek to mitigate credit risk by adhering to specific underwriting practices and by ongoing monitoring of our loan portfolio. We track certain credit quality indicators that include: trends related to the risk rating of commercial loans, the level of classified commercial loans, net charge-offs, nonperforming loans, and general economic conditions. The Company's loan review function generally analyzes all commercial loan relationships greater than \$4.0 million annually and at various times during the year. Smaller commercial and retail loans are sampled for review during the year.

Nonperforming assets consist of nonaccrual loans, accrual loans contractually past due 90 days or more, unseasoned troubled debt restructurings (TDRs), and OREO. Ongoing activity in the classification and categories of nonperforming loans include collections on delinquencies, foreclosures, loan restructurings, and movements into or out of the nonperforming classification due to changing economic conditions, borrower financial capacity, or resolution efforts. See Note 5, Credit Quality, to the Condensed Consolidated Financial Statements in Item 1 of this report.

The following table summarizes the components of nonperforming assets and presents additional details for nonperforming and restructured loans as of the periods indicated:

|                                          | September 30, 2016 | December 31, 2015 | September 30, 2015 |
|------------------------------------------|--------------------|-------------------|--------------------|
| <i>(Amounts in thousands)</i>            |                    |                   |                    |
| <b>Non-covered nonperforming</b>         |                    |                   |                    |
| Nonaccrual loans                         | \$ 17,487          | \$ 17,847         | \$ 17,100          |
| Accruing loans past due 90 days or more  | 62                 |                   | 3                  |
| TDRs <sup>(1)</sup>                      | 115                | 73                | 74                 |
| Total nonperforming loans                | 17,664             | 17,920            | 17,177             |
| Non-covered OREO                         | 4,052              | 4,873             | 5,088              |
| Total non-covered nonperforming assets   | \$ 21,716          | \$ 22,793         | \$ 22,265          |
| <b>Covered nonperforming</b>             |                    |                   |                    |
| Nonaccrual loans                         | \$ 688             | \$ 647            | \$ 815             |
| Total nonperforming loans                | 688                | 647               | 815                |
| Covered OREO                             | 2,437              | 4,034             | 4,079              |
| Total covered nonperforming assets       | \$ 3,125           | \$ 4,681          | \$ 4,894           |
| <b>Total nonperforming</b>               |                    |                   |                    |
| Nonaccrual loans                         | \$ 18,175          | \$ 18,494         | \$ 17,915          |
| Accruing loans past due 90 days or more  | 62                 |                   | 3                  |
| TDRs <sup>(1)</sup>                      | 115                | 73                | 74                 |
| Total nonperforming loans                | 18,352             | 18,567            | 17,992             |
| OREO                                     | 6,489              | 8,907             | 9,167              |
| Total nonperforming assets               | \$ 24,841          | \$ 27,474         | \$ 27,159          |
| <b>Additional Information</b>            |                    |                   |                    |
| Performing TDRs <sup>(2)</sup>           | \$ 13,336          | \$ 13,889         | \$ 13,965          |
| Total TDRs <sup>(3)</sup>                | 13,451             | 13,962            | 14,039             |
| <b>Non-covered ratios</b>                |                    |                   |                    |
| Nonperforming loans to total loans       | 1.00%              | 1.10%             | 1.07%              |
| Nonperforming assets to total assets     | 0.91%              | 0.96%             | 0.93%              |
| Non-PCI allowance to nonperforming loans | 111.08%            | 112.61%           | 117.06%            |

|                                                  |         |         |         |
|--------------------------------------------------|---------|---------|---------|
| Non-PCI allowance to total loans                 | 1.11%   | 1.24%   | 1.26%   |
| <b>Total ratios</b>                              |         |         |         |
| Nonperforming loans to total loans               | 1.00%   | 1.09%   | 1.06%   |
| Nonperforming assets to total assets             | 1.01%   | 1.12%   | 1.10%   |
| Allowance for loan losses to nonperforming loans | 106.98% | 108.97% | 111.87% |
| Allowance for loan losses to total loans         | 1.07%   | 1.19%   | 1.19%   |

- (1) TDRs restructured within the past six months and nonperforming TDRs exclude nonaccrual TDRs of \$268 thousand, \$923 thousand, and \$485 thousand for the periods ended September 30, 2016, December 31, 2015, and September 30, 2015, respectively.
- (2) TDRs with six months or more of satisfactory payment performance exclude nonaccrual TDRs of \$1.04 million, \$416 thousand, and \$338 thousand for the periods ended September 30, 2016, December 31, 2015, and September 30, 2015, respectively.
- (3) Total TDRs exclude nonaccrual TDRs of \$1.31 million, \$1.34 million, and \$823 thousand for the periods ended September 30, 2016, December 31, 2015, and September 30, 2015, respectively.

Non-covered nonperforming loans as a percent of total non-covered loans totaled 1.00% as of September 30, 2016, 1.10% as of December 31, 2015, and 1.07% as of September 30, 2015. Non-covered nonperforming assets as a percent of total non-covered assets totaled 0.91% as of September 30, 2016, 0.96% as of December 31, 2015, and 0.93% as of September 30, 2015.

Non-covered nonaccrual loans as of September 30, 2016, decreased \$360 thousand, or 2.02%, from December 31, 2015, and increased \$387 thousand, or 2.26%, from September 30, 2015. Non-covered nonaccrual loans were largely attributed to single family owner occupied loans (42.33%) and non-farm, non-residential loans (40.46%) as of September 30, 2016. As of September 30, 2016, approximately \$283 thousand, or 1.62%, of non-covered nonaccrual loans were attributed to performing



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

Non-covered delinquent loans, comprised of loans 30 days or more past due and nonaccrual loans, as of September 30, 2016, decreased \$1.07 million, or 3.83%, to \$26.81 million from December 31, 2015, and increased \$3.85 million, or 16.76%, from September 30, 2015. Non-covered delinquent loans as a percent of total non-covered loans totaled 1.51% as of September 30, 2016, which included loans past due (0.53%) and nonaccrual loans (0.98%).

When restructuring loans for borrowers experiencing financial difficulty, we generally make concessions in interest rates, loan terms, and/or amortization terms. Certain TDRs are classified as nonperforming when modified and are returned to performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs. Accruing TDRs as of September 30, 2016, decreased \$511 thousand, or 3.66%, to \$13.45 million from December 31, 2015, and \$588 thousand, or 4.19%, from September 30, 2015. Nonperforming accruing TDRs as of September 30, 2016, increased \$42 thousand from December 31, 2015, and \$41 thousand from September 30, 2015. Accruing nonperforming TDRs as a percent of total accruing TDRs totaled 0.85% as of September 30, 2016, 0.52% as of December 31, 2015, and 0.53% as of September 30, 2015. Specific reserves on TDRs totaled \$552 thousand as of September 30, 2016, \$590 thousand as of December 31, 2015, and \$641 thousand as of September 30, 2015.

Non-covered OREO, which is carried at the lesser of estimated net realizable value or cost, decreased \$821 thousand, or 16.85%, as of September 30, 2016, from December 31, 2015, and \$1.04 million, or 20.36%, from September 30, 2015. Non-covered OREO consisted of 26 properties with an average holding period of 10 months as of September 30, 2016. The net loss on the sale of OREO totaled \$184 thousand for the third quarter of 2016 compared to \$1.08 million for the same quarter of 2015 and \$1.00 million for the first nine months of 2016 compared to \$1.50 million for the same period of 2015.

The following table details activity within OREO for the periods indicated:

|                               | Nine Months Ended September 30, |          |          |             |          |           |
|-------------------------------|---------------------------------|----------|----------|-------------|----------|-----------|
|                               | 2016                            |          |          | 2015        |          |           |
|                               | Non-covered                     | Covered  | Total    | Non-covered | Covered  | Total     |
| <i>(Amounts in thousands)</i> |                                 |          |          |             |          |           |
| Beginning balance             | \$ 4,873                        | \$ 4,034 | \$ 8,907 | \$ 6,638    | \$ 6,324 | \$ 12,962 |
| Additions                     | 2,452                           | 1,200    | 3,652    | 2,479       | 1,660    | 4,139     |
| Disposals                     | (2,561)                         | (2,131)  | (4,692)  | (3,189)     | (2,994)  | (6,183)   |
| Valuation adjustments         | (712)                           | (666)    | (1,378)  | (840)       | (911)    | (1,751)   |
| Ending balance                | \$ 4,052                        | \$ 2,437 | \$ 6,489 | \$ 5,088    | \$ 4,079 | \$ 9,167  |

#### *Allowance for Loan Losses*

The allowance for loan losses is maintained at a level management deems sufficient to absorb probable loan losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and recoveries of prior loan charge-offs and decreased by loans charged off. The provision for loan losses is calculated and charged to expense to bring the allowance to an appropriate level using a systematic process of measurement that requires significant judgments and estimates.

Management performs quarterly assessments to determine the appropriate level of the allowance for loan losses. The allowance for loan losses includes specific allocations related to significant individual loans and credit relationships and general reserves related to loans not individually evaluated. Loans not individually evaluated are grouped into pools based on similar risk characteristics. Management's general reserve allocations are based on judgments of qualitative and quantitative factors about macro and micro economic conditions reflected in the loan portfolio and the economy. Our qualitative risk factors reflect a stable risk of loan losses as of September 30, 2016, due to consistent asset quality metrics and relatively stable business and economic conditions in our primary market areas. Loans acquired in business combinations that are deemed impaired at acquisition are grouped into pools and evaluated separately from the non-PCI portfolio. Our PCI loans were aggregated into the following loan pools as of September 30, 2016: Waccamaw commercial, Waccamaw serviced home equity lines, Waccamaw residential, Peoples Bank of Virginia ( Peoples ) commercial, and Peoples residential. There were five PCI loan pools as of September 30, 2016, compared to six PCI loan pools as of December 31, 2015, and six loan pools as of September 30, 2015. The cash flow analysis performed for the PCI loan pools identified one pool as impaired as of September 30, 2016, compared to two pools as of December 31, 2015, and two loan pools as of September 30, 2015. The PCI loan provision is offset by an adjustment to the FDIC indemnification asset to reflect the indemnified portion of the post-acquisition exposure. See Critical Accounting Estimates above, as well as Significant Accounting Policies in Note 1, Basis of Presentation, and Note 6, Allowance for Loan Losses, to the Condensed Consolidated Financial Statements in Item 1 of this report.

The allowance for loan losses as of September 30, 2016, decreased \$600 thousand, or 2.97%, from December 31, 2015, and \$494 thousand, or 2.45%, from September 30, 2015. The non-PCI allowance as a percent of non-covered loans totaled 1.11% as of September 30, 2016, 1.24% as of December 31, 2015, and 1.26% as of September 30, 2015. Net charge-offs decreased \$125 thousand, or 28.60%, during the third quarter of 2016 and \$474 thousand, or 25.93%, during the first nine months of 2016 compared to the same periods of 2015. The following table presents activity in our allowance for loan losses for the periods indicated:

|                                                                         | Three Months Ended September 30,<br>2016 |               |           | 2015                 |               |           |
|-------------------------------------------------------------------------|------------------------------------------|---------------|-----------|----------------------|---------------|-----------|
|                                                                         | Non-PCI<br>Portfolio                     | PCI Portfolio | Total     | Non-PCI<br>Portfolio | PCI Portfolio | Total     |
| <i>(Amounts in thousands)</i>                                           |                                          |               |           |                      |               |           |
| Beginning balance                                                       | \$ 21,087                                | \$ 12         | \$ 21,099 | \$ 20,144            | \$ 114        | \$ 20,258 |
| (Recovery of) provision for loan losses                                 | (1,154)                                  |               | (1,154)   | 400                  | (94)          | 306       |
| Benefit attributable to the FDIC indemnification asset                  |                                          |               |           |                      | 75            | 75        |
| (Recovery of) provision for loan losses charged to operations           | (1,154)                                  |               | (1,154)   | 400                  | (19)          | 381       |
| Recovery of loan losses recorded through the FDIC indemnification asset |                                          |               |           |                      | (75)          | (75)      |
| Charge-offs                                                             | (772)                                    |               | (772)     | (689)                |               | (689)     |
| Recoveries                                                              | 460                                      |               | 460       | 252                  |               | 252       |
| Net charge-offs                                                         | (312)                                    |               | (312)     | (437)                |               | (437)     |
| Ending balance                                                          | \$ 19,621                                | \$ 12         | \$ 19,633 | \$ 20,107            | \$ 20         | \$ 20,127 |

|                                                                                         | Nine Months Ended September 30,<br>2016 |               |           | 2015                 |               |           |
|-----------------------------------------------------------------------------------------|-----------------------------------------|---------------|-----------|----------------------|---------------|-----------|
|                                                                                         | Non-PCI<br>Portfolio                    | PCI Portfolio | Total     | Non-PCI<br>Portfolio | PCI Portfolio | Total     |
| <i>(Amounts in thousands)</i>                                                           |                                         |               |           |                      |               |           |
| Beginning balance                                                                       | \$ 20,179                               | \$ 54         | \$ 20,233 | \$ 20,169            | \$ 58         | \$ 20,227 |
| Provision for (recovery of) loan losses                                                 | 796                                     | (42)          | 754       | 1,766                | (38)          | 1,728     |
| Benefit attributable to the FDIC indemnification asset                                  |                                         | 1             | 1         |                      | 29            | 29        |
| Provision for (recovery of) loan losses charged to operations                           | 796                                     | (41)          | 755       | 1,766                | (9)           | 1,757     |
| (Recovery of) provision for loan losses recorded through the FDIC indemnification asset |                                         | (1)           | (1)       |                      | (29)          | (29)      |
| Charge-offs                                                                             | (2,691)                                 |               | (2,691)   | (2,940)              |               | (2,940)   |
| Recoveries                                                                              | 1,337                                   |               | 1,337     | 1,112                |               | 1,112     |
| Net charge-offs                                                                         | (1,354)                                 |               | (1,354)   | (1,828)              |               | (1,828)   |

|                |           |       |           |           |       |           |
|----------------|-----------|-------|-----------|-----------|-------|-----------|
| Ending balance | \$ 19,621 | \$ 12 | \$ 19,633 | \$ 20,107 | \$ 20 | \$ 20,127 |
|----------------|-----------|-------|-----------|-----------|-------|-----------|

The loan portfolio is continually monitored for deterioration in credit, which may result in the need to increase the allowance for loan losses in future periods. Management considered the allowance adequate as of September 30, 2016; however, no assurance can be made that additions to the allowance will not be required in future periods.

### *Deposits*

Total deposits as of September 30, 2016, decreased \$11.36 million, or 0.61%, compared to December 31, 2015. Noninterest-bearing deposits increased \$22.00 million while interest-bearing deposits decreased \$8.14 million, savings deposits, which include money market accounts and savings accounts, decreased \$8.86 million, and time deposits decreased \$16.36 million.

## *Borrowings*

Total borrowings as of September 30, 2016, increased \$4.87 million, or 2.22%, compared to December 31, 2015. Short-term

borrowings generally consist of federal funds purchased and retail repurchase agreements. There were no federal funds purchased as of September 30, 2016, or December 31, 2015. The balance of retail repurchase agreements decreased \$20.08 million, or 22.66%, and the weighted average rate decreased 6 basis points to 0.07%, as of September 30, 2016, compared to December 31, 2015.

Long-term borrowings generally consist of wholesale repurchase agreements; FHLB borrowings, including convertible and callable advances; subordinated debt; and other obligations. The balance and weighted average contractual rate of wholesale repurchase agreements remained constant at \$50.00 million and 3.71%, respectively, as of September 30, 2016, compared to December 31, 2015. Wholesale repurchase agreements had contractual maturities between three months and three years as of September 30, 2016. The balance of FHLB borrowings as of September 30, 2016, increased \$25.00 million and the weighted average contractual rate decreased 103 basis points to 3.01%, compared to December 31, 2015. FHLB borrowings had contractual maturities between one month and five years as of September 30, 2016. The balance of subordinated debt remained constant at \$15.46 million as of September 30, 2016, compared to December 31, 2015. The junior subordinated debentures ( *Debentures* ), which are currently callable, carry an interest rate of three-month London InterBank Offered Rate ( *LIBOR* ) plus 2.95% and mature October 8, 2033.

In addition, the Company maintains a \$15.00 million unsecured, committed line of credit with an unrelated financial institution that carries an interest rate of one-month LIBOR plus 2.00% and matures in April 2017. There was no outstanding balance on the line of credit as of September 30, 2016, or December 31, 2015.

## *Liquidity and Capital Resources*

### *Liquidity*

Liquidity is a measure of our ability to raise sufficient cash, or convert assets to cash, to meet our financial obligations. We maintain a liquidity risk management policy and contingency funding policy ( *Liquidity Plan* ) designed to detect potential liquidity issues to protect depositors, creditors, and shareholders. The Liquidity Plan includes various internal and external indicators that are reviewed on a recurring basis by our Asset/Liability Management Committee ( *ALCO* ) and the Board of Directors. ALCO reviews liquidity risk exposure and policies related to liquidity management, ensures that systems and internal controls are consistent with liquidity policies, and provides accurate reports about liquidity needs, sources, and compliance.

We maintained liquidity in the form of unencumbered cash on hand and deposits with other financial institutions of \$65.93 million, availability on federal funds lines with correspondent banks of \$105.00 million, availability from the Federal Reserve Bank discount window of \$9.08 million, unused borrowing capacity with the FHLB of \$495.15 million, and unpledged available-for-sale securities of \$69.04 million as of September 30, 2016. Cash on hand and deposits with other financial institutions and lines of credit with correspondent banks and the Federal Reserve Bank are immediately available to satisfy deposit withdrawals, customer credit needs, and our operations. Our approved lines of credit with correspondent banks are available as backup liquidity sources. Unused borrowing capacity with the FHLB is reported net of letters of credit that collateralize public unit deposits of \$74.32 million as of September 30, 2016. Available-for-sale securities represent a secondary source of liquidity upon conversion to a liquid asset.

As a holding company with no significant operations of its own, the Company's primary sources of liquidity are dividends received from the Bank and borrowings. Dividends paid by the Bank are subject to certain regulatory

limitations. The Company's liquid assets consisted of cash and investment securities totaling \$12.08 million as of September 30, 2016. The Company's cash reserves and investments provide adequate working capital to meet obligations and projected dividends to shareholders for the next twelve months. The Company maintains a \$15.00 million unsecured, committed line of credit with an unrelated financial institution. There was no outstanding balance on the line of credit as of September 30, 2016.

*Capital Adequacy Requirements*

Risk-based capital guidelines, issued by state and federal banking agencies, include balance sheet assets and off-balance sheet arrangements weighted by the risks inherent in the specific asset type. Basel III Capital Rules became effective on January 1, 2015, subject to a four-year phase-in period. The Company's required initial minimum capital ratios under Basel III include:

4.5% Common equity Tier 1 capital to risk-weighted assets

6.0% Tier 1 capital to risk-weighted assets

8.0% Total capital to risk-weighted assets

4.0% Tier 1 leverage ratio

The following table presents our capital ratios as of the dates indicated:

|                                  | September 30, 2016 | December 31, 2015 |
|----------------------------------|--------------------|-------------------|
| Common equity Tier 1 ratio       |                    |                   |
| First Community Bancshares, Inc. | 13.26%             | 14.54%            |
| First Community Bank             | 12.49%             | 13.60%            |
| Tier 1 risk-based capital ratio  |                    |                   |
| First Community Bancshares, Inc. | 13.26%             | 14.73%            |
| First Community Bank             | 12.49%             | 13.60%            |
| Total risk-based capital ratio   |                    |                   |
| First Community Bancshares, Inc. | 14.41%             | 15.95%            |
| First Community Bank             | 13.64%             | 14.82%            |
| Tier 1 leverage ratio            |                    |                   |
| First Community Bancshares, Inc. | 9.85%              | 10.62%            |
| First Community Bank             | 9.24%              | 9.77%             |

Our regulatory capital ratios as of September 30, 2016, decreased from December 31, 2015, primarily due to the phase-in of certain Basel III Capital Rules related to common equity Tier 1 deductions and an increase in risk-weighted assets. Our capital ratios were well in excess of the minimum standards and classified as well capitalized under regulatory capital adequacy standards applicable to that period as of September 30, 2016. Additionally, our capital ratios were in excess of the minimum standards under the Basel III Capital Rules on a fully phased-in basis, if such requirements were in effect, as of September 30, 2016. A description of the Basel III Capital Rules is included in Part I, Item 1 of the Company's 2015 Form 10-K.

#### *Off-Balance Sheet Arrangements*

We extend contractual commitments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. Our exposure to credit loss in the event of nonperformance by other parties to financial instruments is the same as the contractual amount of the instrument. The following table presents our off-balance sheet arrangements as of the dates indicated:

|                                  |                    |                   |
|----------------------------------|--------------------|-------------------|
| <i>(Amounts in thousands)</i>    | September 30, 2016 | December 31, 2015 |
| Commitments to extend credit     | \$ 260,416         | \$ 235,302        |
| Financial letters of credit      | 4,650              | 4,485             |
| Performance letters of credit    | 3,331              | 3,280             |
| Total off-balance sheet risk     | \$ 268,397         | \$ 243,067        |
| Reserve for unfunded commitments | \$ 326             | \$ 326            |

#### *Impact of Inflation and Changing Prices*

Our consolidated financial statements and related notes are presented in accordance with GAAP, which requires the measurement of results of operations and financial position in historical dollars. Inflation may cause a rise in price levels and changes in the relative purchasing power of money. These inflationary effects are not reflected in historical dollar measurements. The primary effect of inflation on our operations is increased operating costs. In management's opinion, interest rates have a greater impact on our financial performance than inflation. Interest rates do not necessarily fluctuate in the same direction, or to the same extent, as the price of goods and services; therefore, the

effect of inflation on businesses with large investments in property, plant, and inventory is generally more significant than the effect on financial institutions. The U.S. inflation rate continues to be relatively stable, and management believes that any changes in inflation will not be material to our financial performance.

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

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



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

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

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

The following table summarizes the impact of immediate and sustained rate shocks in the interest rate environment on net interest income. The model simulates rate changes of plus 300 to minus 100 basis points from the base simulation and illustrates the prospective effects of hypothetical interest rate changes over a twelve-month period. This modeling technique, although useful, does not take into account all strategies that management might undertake in response to a sudden and sustained rate shock as depicted. As market conditions vary from those assumed in the sensitivity analysis, actual results will differ due to prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other internal and external variables. The Federal Open Market Committee maintained a target range for federal funds of 25 to 50 basis points as of September 30, 2016, rendering a complete downward shock of 200 basis points meaningless; thus, downward rate scenarios are limited to minus 100 basis points. In the downward rate shocks presented, benchmark interest rates are assumed to have floors near 0%.

|                                                              | September 30,<br>2016 |               | December 31,<br>2015 |               |
|--------------------------------------------------------------|-----------------------|---------------|----------------------|---------------|
|                                                              | Change in             | Percent       | Change in            | Percent       |
| <i>(Amounts in thousands, except percents)</i>               | Net Interest Income   |               | Net Interest Income  |               |
| <b>Increase (Decrease) in Interest Rates in Basis Points</b> | <b>Change</b>         | <b>Change</b> | <b>Change</b>        | <b>Change</b> |
| 300                                                          | \$ 1,121              | 1.4%          | \$ (1,162)           | -1.4%         |
| 200                                                          | 824                   | 1.0%          | (694)                | -0.9%         |
| 100                                                          | 324                   | 0.4%          | (409)                | -0.5%         |

|       |         |       |         |       |
|-------|---------|-------|---------|-------|
| (100) | (2,064) | -2.5% | (1,813) | -2.2% |
|-------|---------|-------|---------|-------|

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

In connection with this report, we conducted an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of our disclosure controls and procedures under the Exchange Act Rule 13a-15(b). The CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2016.

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

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

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

We assess the adequacy of our internal control over financial reporting quarterly and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. No changes in our internal control over financial reporting occurred during the quarter ended September 30, 2016, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

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

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

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

Our risk factors discuss potential events, trends, or other circumstances that could adversely affect our business, financial condition, results of operations, cash flows, liquidity, access to capital resources, and, consequently, cause the market value of our common stock to decline. These risks could cause our future results to differ materially from historical results and expectations of future financial performance. There may be risks and uncertainties that we have not identified or that we have deemed immaterial that could adversely affect our business; therefore, our risk factors are not intended as an exhaustive list of all risks we face. There have been no material changes from the risk factors previously disclosed in Part I, Item 1A, "Risk Factors," of our 2015 Form 10-K.

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

(a) Not Applicable

(b) Not Applicable

(c) Issuer Purchases of Equity Securities

The following table provides information regarding purchases of our common stock made by us or on our behalf by any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Exchange Act, during the periods indicated:

|                      | <b>Total Number of<br/>Shares<br/>Purchased</b> | <b>Average Price<br/>Paid per Share</b> | <b>Total Number of Shares<br/>Purchased as Part of a Publicly<br/>Announced<br/>Plan</b> | <b>Maximum Number of Shares<br/>that May Yet<br/>be Purchased<br/>Under the<br/>Plan<sup>(1)</sup></b> |
|----------------------|-------------------------------------------------|-----------------------------------------|------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| July 1-31, 2016      | 108,377                                         | \$ 22.53                                | 108,377                                                                                  | 665,733                                                                                                |
| August 1-31, 2016    | 62,748                                          | 23.14                                   | 62,748                                                                                   | 603,143                                                                                                |
| September 1-30, 2016 | 100                                             | 23.60                                   | 100                                                                                      | 607,193                                                                                                |
| Total                | 171,225                                         | \$ 22.76                                | 171,225                                                                                  |                                                                                                        |

- (1) Our stock repurchase plan, as amended, authorizes the purchase and retention of up to 5,000,000 shares. The plan has no expiration date and is currently in effect. No determination has been made to terminate the plan or to cease making purchases. We held 4,392,807 shares in treasury as of September 30, 2016.

### ITEM 3. Defaults Upon Senior Securities

None.

### ITEM 4. Mine Safety Disclosures

None.

### ITEM 5. Other Information

None.

### ITEM 6. Exhibits

- (a) Exhibits and index required

#### Exhibit

| <b>No.</b> | <b>Exhibit</b>                                                                      |
|------------|-------------------------------------------------------------------------------------|
| 2.1        | Purchase and Assumption Agreement between First Community Bank and First Bank. (33) |
| 2.2        | Purchase and Assumption Agreement between First Bank and First Community Bank. (34) |

- 3.1 Articles of Incorporation of First Community Bancshares, Inc., as amended (1)
- 3.2 Amended and Restated Bylaws of First Community Bancshares, Inc. (2)
- 4.1 Specimen stock certificate of First Community Bancshares, Inc. (3)
- 4.2 Indenture Agreement dated September 25, 2003. (4)
- 4.3 Declaration of Trust of FCBI Capital Trust dated September 25, 2003, as amended and restated. (5)
- 4.4 Preferred Securities Guarantee Agreement dated September 25, 2003. (6)
- 10.1\*\* First Community Bancshares, Inc. 1999 Stock Option Agreement (7) and Plan. (8)
- 10.1.1\*\* First Community Bancshares, Inc. 1999 Stock Option Plan, Amendment One. (9)
- 10.2\*\* First Community Bancshares, Inc. 2001 Nonqualified Director Stock Option Plan. (10)
- 10.3\*\* Employment Agreement between First Community Bancshares, Inc. and John M. Mendez dated December 16, 2008, as amended and restated (19) and Waiver Agreement. (26)
- 10.4\*\* First Community Bancshares, Inc. and Affiliates Executive Retention Plan (11), Amendment #1 (12), Amendment #2 (29), and Amendment #3. (35)
- 10.5\*\* First Community Bancshares, Inc. Split Dollar Plan and Agreement. (13)
- 10.6\*\* First Community Bancshares, Inc. Supplemental Directors Retirement Plan, as amended and restated (14) and Amendment #2. (36)
- 10.7\*\* First Community Bancshares, Inc. Nonqualified Supplemental Cash or Deferred Retirement Plan, as amended and restated. (15)
- 10.11\*\* First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan (16) and Stock Award Agreement. (17)
- 10.12\*\* First Community Bancshares, Inc. 2012 Omnibus Equity Compensation Plan. (28)
- 10.13\*\* First Community Bancshares, Inc. Directors Deferred Compensation Plan, as amended and restated. (18)
- 10.14\*\* Employment Agreement between First Community Bancshares, Inc. and David D. Brown dated April 16, 2015. (20)

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|         |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|---------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.16** | Employment Agreement between First Community Bancshares, Inc. and E. Stephen Lilly dated April 16, 2015. (21)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| 10.17** | Employment Agreement between First Community Bancshares, Inc. and Gary R. Mills dated April 16, 2015. (22)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 10.18** | Employment Agreement between First Community Bancshares, Inc. and Martyn A. Pell dated April 16, 2015 (23) and Amendment #1 dated May 27, 2016. (35)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| 10.19** | Employment Agreement between First Community Bank and Robert L. Schumacher dated April 16, 2015. (24)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 10.20** | Employment Agreement between First Community Bancshares, Inc. and William P. Stafford, II dated April 16, 2015. (32)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| 10.21** | Employment Agreement between First Community Bank and Mark R. Evans dated July 31, 2009. (25)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| 10.22** | Form of Restricted Stock Grant Agreement under First Community Bancshares, Inc. 2012 Omnibus Equity Compensation Plan. (30)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| 10.23** | Separation Agreement and Release between First Community Bancshares, Inc. and John M. Mendez dated August 28, 2013. (31)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 11      | Statement Regarding Computation of Earnings per Share. (27)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| 31.1*   | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 31.2*   | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 32*     | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| 101***  | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of September 30, 2016, (Unaudited), and December 31, 2015; (ii) Condensed Consolidated Statements of Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015 ; (iii) Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015; (iv) Condensed Consolidated Statements of Stockholders Equity (Unaudited) for the nine months ended September 30, 2016 and 2015; (v) Condensed Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2016 and 2015; and (vi) Notes to Condensed Consolidated Financial Statements (Unaudited). |

\* Incorporated herewith.

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

\*\*\* Submitted electronically herewith.

- (1) Incorporated by reference from Exhibit 3(i) of the Quarterly Report on Form 10-Q for the period ended June 30, 2010, filed on August 16, 2010.
- (2) Incorporated by reference from Exhibit 3.1 of the Current Report on Form 8-K dated February 23, 2016, filed on February 25, 2016.
- (3) Incorporated by reference from Exhibit 4.1 of the Annual Report on Form 10-K for the period ended December 31, 2002, filed on March 25, 2003, amended on June 30, 2003.
- (4) Incorporated by reference from Exhibit 4.2 of the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.

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- (5) Incorporated by reference from Exhibit 4.3 of the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.
- (6) Incorporated by reference from Exhibit 4.4 of the Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed on November 10, 2003.
- (7) Incorporated by reference from Exhibit 10.5 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
- (8) Incorporated by reference from Exhibit 10.1 of the Annual Report on Form 10-K for the period ended December 31, 1999, filed on March 30, 2000, amended on April 13, 2000.
- (9) Incorporated by reference from Exhibit 10.1.1 of the Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed on May 7, 2004.
- (10) Incorporated by reference from Exhibit 10.4 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002.
- (11) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated December 30, 2008, filed on January 5, 2009.
- (12) Incorporated by reference from Exhibit 10.3 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010.
- (13) Incorporated by reference from Exhibit 10.5 of the Annual Report on Form 10-K for the period ended December 31, 1999, filed on March 30, 2000, amended on April 13, 2000.
- (14) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010.



- (15) Incorporated by reference from Exhibit 99.1 of the Current Report on Form 8-K dated August 22, 2006, filed on August 23, 2006.
- (16) Incorporated by reference from Annex B to the 2004 First Community Bancshares, Inc. Definitive Proxy Statement filed on March 15, 2004.
- (17) Incorporated by reference from Exhibit 10.13 of the Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed on August 6, 2004.
- (18) Incorporated by reference from Exhibit 99.2 of the Current Report on Form 8-K dated August 22, 2006, filed on August 23, 2006.
- (19) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated and filed on December 16, 2008.
- (20) Incorporated by reference from Exhibit 10.3 of the Current Report on Form 8-K dated and filed on April 16, 2015.
- (21) Incorporated by reference from Exhibit 10.5 of the Current Report on Form 8-K dated and filed on April 16, 2015.
- (22) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated and filed on April 16, 2015.
- (23) Incorporated by reference from Exhibit 10.4 of the Current Report on Form 8-K dated and filed on April 16, 2015.
- (24) Incorporated by reference from the Current Report on Form 8-K dated and filed on April 16, 2015.
- (25) Incorporated by reference from Exhibit 2.1 of the Current Report on Form 8-K dated April 2, 2009, filed on April 3, 2009.
- (26) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010.
- (27) Incorporated by reference from Note 15 of the Notes to Condensed Consolidated Financial Statements included herein.
- (28) Incorporated by reference from the 2012 First Community Bancshares, Inc. Definitive Proxy Statement filed on March 7, 2012.
- (29) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated February 21, 2013, filed on February 25, 2013.
- (30) Incorporated by reference from Exhibit 99.1 of the Current Report on Form 8-K dated and filed May 28, 2013.
- (31) Incorporated by reference from Exhibit 99.1 of the Current Report on Form 8-K/A dated August 12, 2013, filed on September 3, 2013.
- (32) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated and filed on April 16, 2015.
- (33) Incorporated by reference from Exhibit 2.1 of the Current Report on Form 8-K dated March 3, 2016, filed on March 4, 2016.
- (34) Incorporated by reference from Exhibit 2.2 of the Current Report on Form 8-K dated March 3, 2016, filed on March 4, 2016.
- (35) Incorporated by reference from Exhibit 10.1 of the Current Report on Form 8-K dated May 24, 2016, filed on May 31, 2016.
- (36) Incorporated by reference from Exhibit 10.2 of the Current Report on Form 8-K dated May 24, 2016, filed on May 31, 2016.

## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 4<sup>th</sup> day of November, 2016.

First Community Bancshares, Inc.

(Registrant)

/s/ William P. Stafford, II  
William P. Stafford, II  
Chief Executive Officer  
(Principal Executive Officer)

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

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**EXHIBIT INDEX**

Exhibit

| No.  | Exhibit                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| 32   | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 101  | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of September 30, 2016, (Unaudited), and December 31, 2015; (ii) Condensed Consolidated Statements of Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015; (iii) Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015; (iv) Condensed Consolidated Statements of Stockholders Equity (Unaudited) for the nine months ended September 30, 2016 and 2015; (v) Condensed Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2016 and 2015; and (vi) Notes to Condensed Consolidated Financial Statements (Unaudited). |