

# Section 1: 10-Q (FORM 10-Q)

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

FORM 10-Q

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

For the quarterly period ended **June 30, 2020**  
or

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

Commission file number: **000-19297**

**FIRST COMMUNITY BANKSHARES, INC.**

(Exact name of registrant as specified in its charter)

**Virginia**

(State or other jurisdiction of incorporation or organization)

**55-0694814**

(IRS Employer Identification No.)

**P.O. Box 989  
Bluefield, Virginia**

(Address of principal executive offices)

**24605-0989**

(Zip Code)

**(276) 326-9000**

(Registrant's telephone number, including area code)

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

<b>Title of each class</b>	<b>Trading Symbol(s)</b>	<b>Name of each exchange on which registered</b>
Common Stock (\$1.00 par value)	FCBC	NASDAQ Global Select

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 every Interactive Data File required to be submitted 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 such files).

Yes  No

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

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of July 31, 2020, there were 17,710,285 shares outstanding of the registrant's Common Stock, \$1.00 par value.



**FIRST COMMUNITY BANKSHARES, INC.**  
**FORM 10-Q**  
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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

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 shareholders, and other communications that represent the Company's beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions are made in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," and other similar expressions identify forward-looking statements. The following factors, among others, could cause financial performance to differ materially from that expressed in such forward-looking statements:

- the effects of the COVID-19 pandemic, including the negative impacts and disruptions to the communities the Company serves, and the domestic and global economy, which may have an adverse effect on the Company's business;
- 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;
- 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 the Company's 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 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 noninterest, or fee, income being less than expected;
- unanticipated regulatory or judicial proceedings;
- changes in consumer spending and saving habits; and
- the Company's success at managing the risks mentioned above.

This list of important factors is not exclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, 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 file with the Securities and Exchange Commission. Therefore, the Company cautions you not to place undue reliance on forward-looking information and statements. Further, statements about the potential effects of the COVID-19 pandemic on our business, financial condition, liquidity and results of operations may contain forward-looking statements and are subject to the risk that the actual effects may differ, possibly materially, from what is reflected in those forward-looking statements due to factors and future developments that are uncertain, unpredictable and in many cases beyond our control. The Company does 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 the Company including the risk factors presented in Part II, Item 1A, "Risk Factors," of this report and Part I, Item 1A, "Risk Factors," of the Company's Annual Report on Form 10-K for the year ended December 31, 2019.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2020</b>	<b>December 31, 2019<sup>(1)</sup></b>
	(Unaudited)	
<i>(Amounts in thousands, except share and per share data)</i>		
<b>Assets</b>		
Cash and due from banks	\$ 57,507	\$ 66,818
Federal funds sold	361,680	148,000
Interest-bearing deposits in banks	2,305	2,191
Total cash and cash equivalents	421,492	217,009
Debt securities available for sale	98,367	169,574
Loans held for sale	-	263
Loans held for investment, net of unearned income (includes covered loans of \$11,257 and \$12,861, respectively)	2,136,817	2,114,460
Allowance for loan losses	(23,758)	(18,425)
Loans held for investment, net	2,113,059	2,096,035
FDIC indemnification asset	1,943	2,883
Premises and equipment, net	62,658	62,824
Other real estate owned	2,181	3,969
Interest receivable	8,380	6,677
Goodwill	129,565	129,565
Other intangible assets	7,798	8,519
Other assets	103,623	101,529
Total assets	<u>\$ 2,949,066</u>	<u>\$ 2,798,847</u>
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest-bearing	\$ 752,899	\$ 627,868
Interest-bearing	1,744,947	1,702,044
Total deposits	2,497,846	2,329,912
Securities sold under agreements to repurchase	1,100	1,601
Interest, taxes, and other liabilities	34,290	38,515
Total liabilities	2,533,236	2,370,028
<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; none outstanding	-	-
Common stock, \$1 par value; 50,000,000 shares authorized; 24,306,138 shares issued and 17,709,569 outstanding at June 30, 2020; 24,238,907 shares issued and 18,376,991 outstanding at December 31, 2019	17,710	18,377
Additional paid-in capital	172,601	192,413
Retained earnings	226,627	219,535

Accumulated other comprehensive loss		(1,108)	(1,506)
Total stockholders' equity		415,830	428,819
Total liabilities and stockholders' equity		\$ 2,949,066	\$ 2,798,847

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
<i>(Amounts in thousands, except share and per share data)</i>				
<b>Interest income</b>				
Interest and fees on loans	\$ 26,991	\$ 22,721	\$ 55,049	\$ 44,900
Interest on securities -- taxable	238	246	618	655
Interest on securities -- tax-exempt	475	649	1,013	1,334
Interest on deposits in banks	82	766	615	1,104
Total interest income	27,786	24,382	57,295	47,993
<b>Interest expense</b>				
Interest on deposits	1,445	1,392	3,270	2,697
Interest on short-term borrowings	2	1	4	121
Total interest expense	1,447	1,393	3,274	2,818
<b>Net interest income</b>	26,339	22,989	54,021	45,175
Provision for credit losses	3,831	1,585	7,331	2,805
<b>Net interest income after provision for loan losses</b>	22,508	21,404	46,690	42,370
<b>Noninterest income</b>				
Wealth management	854	884	1,698	1,629
Service charges on deposits	2,560	3,699	6,291	7,107
Other service charges and fees	2,617	2,129	4,848	4,178
Net (loss) gain on sale of securities	-	(43)	385	(43)
Net FDIC indemnification asset amortization	(483)	(516)	(969)	(1,068)
Litigation settlements	-	2,025	-	3,700
Other operating income	1,365	471	2,209	1,226
Total noninterest income	6,913	8,649	14,462	16,729
<b>Noninterest expense</b>				
Salaries and employee benefits	11,015	9,153	22,401	18,319
Occupancy expense	1,275	1,082	2,590	2,235
Furniture and equipment expense	1,316	1,062	2,700	2,095
Service fees	1,329	1,231	2,852	2,261
Advertising and public relations	475	513	987	1,037
Professional fees	307	328	540	742
Amortization of intangibles	360	249	721	495
FDIC premiums and assessments	33	150	33	318
Merger expenses	-	-	1,893	-
Other operating expense	2,803	2,883	5,860	5,934
Total noninterest expense	18,913	16,651	40,577	33,436
Income before income taxes	10,508	13,402	20,575	25,663
Income tax expense	2,270	2,951	4,465	5,581
<b>Net income</b>	\$ 8,238	\$ 10,451	\$ 16,110	\$ 20,082
<b>Earnings per common share</b>				
Basic	\$ 0.47	\$ 0.67	\$ 0.90	\$ 1.27
Diluted	0.46	0.66	0.90	1.27
<b>Weighted average shares outstanding</b>				
Basic	17,701,853	15,712,204	17,850,423	15,775,462
Diluted	17,728,300	15,775,320	17,888,325	15,847,498

See Notes to Condensed Consolidated Financial Statements.

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**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
<i>(Amounts in thousands)</i>				
<b>Net income</b>	\$ 8,238	\$ 10,451	\$ 16,110	\$ 20,082
<b>Other comprehensive income, before tax</b>				
Available-for-sale debt securities:				
Change in net unrealized (losses) gains on debt securities without other-than-temporary impairment	(58)	332	1,141	1,550
Reclassification adjustment for net (gains) losses recognized in net income	-	43	(385)	43
Net unrealized (losses) gains on available-for-sale debt securities	(58)	375	756	1,593
Employee benefit plans:				
Net actuarial (loss) gain	-	1	(445)	(406)
Reclassification adjustment for amortization of prior service cost and net actuarial loss recognized in net income	97	70	193	139
Net unrealized gains (losses) on employee benefit plans	97	71	(252)	(267)
<b>Other comprehensive income, before tax</b>	39	446	504	1,326
Income tax expense	8	94	106	278
<b>Other comprehensive income, net of tax</b>	31	352	398	1,048
<b>Total comprehensive income</b>	\$ 8,269	\$ 10,803	\$ 16,508	\$ 21,130

See Notes to Condensed Consolidated Financial Statements.

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**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)**  
**THREE MONTHS ENDED**  
**June 30, 2020 and 2019**

<i>(Amounts in thousands, except share and per share data)</i>	<i>Preferred Stock</i>	<i>Common Stock</i>	<i>Additional Paid-in Capital</i>	<i>Retained Earnings</i>	<i>Accumulated Other Comprehensive Income (Loss)</i>	<i>Total</i>
Balance April 1, 2019	\$ -	\$ 15,818	\$ 115,914	\$ 202,103	\$ (733)	\$ 333,102
Net income	-	-	-	10,451	-	10,451
Other comprehensive income	-	-	-	-	352	352
Common dividends declared -- \$0.25 per share	-	-	-	(3,936)	-	(3,936)
Equity-based compensation expense	-	4	145	-	-	149
Common stock options exercised -- 2,927 shares	-	2	56	-	-	58
Issuance of common stock to 401(k) plan -- 2,555 shares	-	3	84	-	-	87
Repurchase of common shares -- 194,000 shares at \$33.90 per share	-	(194)	(6,383)	-	-	(6,577)
Balance June 30, 2019	\$ -	\$ 15,633	\$ 109,816	\$ 208,618	\$ (381)	\$ 333,686
Balance April 1, 2020	\$ -	\$ 17,700	\$ 172,231	\$ 222,814	\$ (1,139)	\$ 411,606
Net income	-	-	-	8,238	-	8,238
Other comprehensive income	-	-	-	-	31	31
Common dividends declared -- \$0.25 per share	-	-	-	(4,425)	-	(4,425)
Equity-based compensation expense	-	5	261	-	-	266
Issuance of common stock to 401(k) plan -- 5,294 shares	-	5	109	-	-	114
Balance June 30, 2020	\$ -	\$ 17,710	\$ 172,601	\$ 226,627	\$ (1,108)	\$ 415,830

See Notes to Condensed Consolidated Financial Statements.

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**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)**  
**SIX MONTHS ENDED**  
**June 30, 2020 and 2019**

<i>(Amounts in thousands, except share and per share data)</i>	<u>Preferred Stock</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
Balance January 1, 2019	\$ -	\$ 16,007	\$ 122,486	\$ 195,793	\$ (1,429)	\$ 332,857
Net income	-	-	-	20,082	-	20,082
Other comprehensive income	-	-	-	-	1,048	1,048
Common dividends declared -- \$0.46 per share	-	-	-	(7,257)	-	(7,257)
Equity-based compensation expense	-	42	964	-	-	1,006
Common stock options exercised -- 4,345 shares	-	4	78	-	-	82
Issuance of common stock to 401(k) plan -- 6,653 shares	-	7	220	-	-	227
Repurchase of common shares -- 426,900 shares at \$33.63 per share	-	(427)	(13,932)	-	-	(14,359)
Balance June 30, 2019	<u>\$ -</u>	<u>\$ 15,633</u>	<u>\$ 109,816</u>	<u>\$ 208,618</u>	<u>\$ (381)</u>	<u>\$ 333,686</u>
Balance January 1, 2020	\$ -	\$ 18,377	\$ 192,413	\$ 219,535	\$ (1,506)	\$ 428,819
Net income	-	-	-	16,110	-	16,110
Other comprehensive income	-	-	-	-	398	398
Common dividends declared -- \$0.50 per share	-	-	-	(9,018)	-	(9,018)
Equity-based compensation expense	-	56	1,049	-	-	1,105
Issuance of common stock to 401(k) plan -- 11,911 shares	-	12	276	-	-	288
Repurchase of common shares -- 734,653 shares at \$29.77 per share	-	(735)	(21,137)	-	-	(21,872)
Balance June 30, 2020	<u>\$ -</u>	<u>\$ 17,710</u>	<u>\$ 172,601</u>	<u>\$ 226,627</u>	<u>\$ (1,108)</u>	<u>\$ 415,830</u>

See Notes to Condensed Consolidated Financial Statements.

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**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

<i>(Amounts in thousands)</i>	<u>Six Months Ended June 30,</u>	
	<u>2020</u>	<u>2019</u>
<b>Operating activities</b>		
Net income	\$ 16,110	\$ 20,082
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	7,331	2,805
Depreciation and amortization of premises and equipment	2,209	1,565
Amortization of premiums on investments, net	1,304	116
Amortization of FDIC indemnification asset, net	969	1,068
Amortization of intangible assets	721	495
Accretion on acquired loans	(3,456)	(2,154)
Equity-based compensation expense	1,105	1,006
Issuance of common stock to 401(k) plan	288	227
Gain on sale of premises and equipment, net	(1)	(183)
Loss on sale of other real estate owned	330	557
(Gain) Loss on sale of securities	(385)	43
(Increase) decrease in accrued interest receivable	(1,703)	164
Increase in other operating activities	(6,608)	(342)
Net cash provided by operating activities	<u>18,214</u>	<u>25,449</u>
<b>Investing activities</b>		
Proceeds from sale of securities available for sale	51,027	13,897
Proceeds from maturities, prepayments, and calls of securities available for sale	20,018	23,824

Proceeds from maturities and calls of securities held to maturity	-	25,000
Payments to acquire securities available for sale	-	(2,234)
(Originations of) proceeds from repayment of loans, net	(20,992)	51,555
(Purchase of) proceeds from FHLB stock, net	(12)	129
Payments to the FDIC	(29)	(20)
Proceeds from sale of premises and equipment	65	948
Payments to acquire premises and equipment	(2,125)	(4,952)
Proceeds from sale of other real estate owned	1,814	1,542
Net cash provided by investing activities	49,766	109,689
<b>Financing activities</b>		
Increase in noninterest-bearing deposits, net	125,031	21,023
Increase (decrease) in interest-bearing deposits, net	42,903	(28,735)
Repayments of securities sold under agreements to repurchase, net	(501)	(26,287)
Repayments of FHLB and other borrowings, net	(40)	-
Proceeds from stock options exercised	-	82
Payments for repurchase of common stock	(21,872)	(14,359)
Payments of common dividends	(9,018)	(7,257)
Net cash provided by (used in) financing activities	136,503	(55,533)
Net increase in cash and cash equivalents	204,483	79,605
Cash and cash equivalents at beginning of period	217,009	76,873
Cash and cash equivalents at end of period	<u>\$ 421,492</u>	<u>\$ 156,478</u>

#### Supplemental disclosure -- cash flow information

Cash paid for interest	\$ 2,960	\$ 2,899
Cash paid for income taxes	4,547	5,337

#### Supplemental transactions -- noncash items

Transfer of loans to other real estate owned	621	2,694
Loans originated to finance other real estate owned	265	471
Decrease in accumulated other comprehensive loss	398	1,048

See Notes to Condensed Consolidated Financial Statements.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

#### Note 1. Basis of Presentation

##### General

First Community Bankshares, Inc. (the “Company”), a financial holding company, was founded in 1989 and incorporated under the laws of the Commonwealth of Virginia in 2018. The Company is the successor to First Community Bancshares, Inc., a Nevada corporation, pursuant to an Agreement and Plan of Reincorporation and Merger, the sole purpose of which was to change the Company’s state of incorporation from Nevada to Virginia. The Company’s principal executive office is located at One Community Place, Bluefield, Virginia. The Company provides banking products and services to individual and commercial customers through its wholly owned subsidiary First Community Bank (the “Bank”), a Virginia-chartered banking institution founded in 1874. The Bank operates as First Community Bank in Virginia, West Virginia, and North Carolina and People’s Community Bank, a Division of First Community Bank, in Tennessee. The Bank offers wealth management and investment advice through its Trust Division and wholly owned subsidiary First Community Wealth Management (“FCWM”). Unless the context suggests otherwise, the terms “First Community,” “Company,” “we,” “our,” and “us” refer to First Community Bankshares, Inc. and its subsidiaries as a consolidated entity.

##### Principles of Consolidation

The Company’s accounting and reporting policies conform with U.S. generally accepted accounting principles (“GAAP”) and prevailing practices in the banking industry. The consolidated financial statements include all accounts of the Company and its wholly owned subsidiaries and eliminate all intercompany balances and transactions. The Company operates in one business segment, Community Banking, which consists of all operations, including commercial and consumer banking, lending activities, and wealth management. Operating results for interim periods are *not* necessarily indicative of results that *may* be expected for other interim periods or for the full year. In management’s opinion, the accompanying unaudited interim condensed consolidated financial statements contain all necessary adjustments, including normal recurring accruals, and disclosures for a fair presentation.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2019 (the “2019 Form 10-K”), as filed with the Securities and Exchange Commission (the “SEC”) on March 13, 2020. The condensed consolidated balance sheet as of December 31, 2019, has been derived from the audited consolidated financial statements.



### ***Reclassifications***

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 net cash flow.

### ***Use of Estimates***

Preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that require the most subjective or complex judgments relate to fair value measurements, investment securities, the allowance for loan losses, goodwill and other intangible assets, and income taxes. A discussion of the Company's application of critical accounting estimates is included in "Critical Accounting Estimates" in Item 2 of this report.

### ***Significant Accounting Policies***

The Company's significant accounting policies are included in Note 1, "Basis of Presentation and Significant Accounting Policies," of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's 2019 Form 10-K.

### ***Risks and Uncertainties***

#### **Recent COVID-19 Virus Developments –**

During the *first* half of 2020, government reaction to the novel coronavirus ("COVID-19") pandemic significantly disrupted local, national, and global economies and adversely impacted a broad range of industries, including banking and other financial services.

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### Company Response to COVID-19 –

As COVID-19 events unfolded during the *first* half of 2020, the Company implemented various plans, strategies and protocols to protect its employees, maintain services for customers, assure the functional continuity of its operating systems, controls and processes, and mitigate financial risks posed by changing market conditions. In particular, the Company took the following actions, among others:

- Implemented its board-approved pandemic business continuity plan
- Appointed an internal pandemic preparedness task force comprised of the Company’s management to address both operational and financial risks posed by COVID-19
- Modified branch operations:
  - Branch lobbies remain available, but on a limited appointment-only basis
  - Most transactions conducted via drive-throughs
  - Increased emphasis on digital banking platforms
- Implemented physical separation of critical operational workforce for Bank and non-Bank financial services subsidiaries
- Expanded paid time off and health benefits for employees
- Implemented work from home strategy:
  - The majority of the Company’s non-branch, operational employees (approximately 60% of the Company’s back office workforce) are working remotely
  - Geographically separated work locations of Bank and Company CEO’s and most other executive management team members
  - Suspended work-related travel
- Implemented a pay differential for employees continuing to work at branch or back office locations which ended *May 31, 2020*
- Adopted self-quarantine procedures
- Implemented enhanced facility cleaning protocols
- Redeployed staff to critical customer service operations to expedite loan payment deferral requests, Paycheck Protection Program lending efforts, and other operations

### Potential Effects of COVID-19 –

The adverse impact of COVID-19 to the economy has impaired the Company’s customers’ ability to fulfill their financial obligations to the Company, reducing interest income on loans or increasing loan losses. In keeping with Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus, the Company continues to work with COVID-19 affected borrowers to defer loan payments, interest, and fees. Through *June 30, 2020*, the Company has modified or deferred payments on a total of 3,097 loans totaling \$436.11 million in principal; 1,277 commercial loans totaling \$340.00 million in principal, 972 consumer installment loans totaling \$12.92 million in principal, 706 consumer mortgages totaling \$76.01 million in principal, and 142 home equity loans totaling \$7.18 million in principal. Deferred interest and fees for these loans will continue to accrue to income under normal GAAP accounting. However, should eventual credit losses on deferred payments occur, accrued interest income and fees would be reversed, which would negatively impact interest income in future periods. At this time, the Company is unable to project the materiality of any such impact.

The general economic slowdown caused by COVID-19 in local economies in communities served by the Company has affected loan demand and consumption of financial services, generally, reducing interest income, service fees, and the demand for other profitable financial services provided by the Company.

In addition to the general impact of COVID-19, certain provisions of the Coronavirus Aid, Relief and Economic Security (“CARES”) Act, as well as other legislative and regulatory actions *may* materially impact the Company. The Company is participating in the Paycheck Protection Program (“PPP”), administered by the Small Business Administration (“SBA”), in an attempt to assist its customers. Per the terms of the program, PPP loans have a *two*-year term, earn interest at 1%, are fully guaranteed by the SBA, and are partially or totally forgivable if administered by the borrower according to guidance provided by the SBA. The Company believes the majority of these loans have the potential to be forgiven by the SBA if administered in accordance with the terms of the program. Through *June 30, 2020*, the Company processed 758 loans with original principal balances totaling \$60.23 million through the PPP.

COVID-19 could cause a sustained decline in the Company’s stock price or the occurrence of an event that could, under certain circumstances, create the impairment of goodwill. In the event the Company deems all or a portion of its goodwill to be impaired, the Company could record a non-cash charge to earnings for the amount of such impairment. Such a charge would have *no* impact on tangible or regulatory capital.

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To date, the Company has identified *no* material, unmitigated operational or internal control challenges or risks and anticipates *no* significant challenges to its ability to maintain systems and controls as a result of the actions taken to prevent the spread of COVID-19. In addition, the Company currently faces *no* material resource constraints arising due to implementation of the business continuity plan.

It is impossible to predict the full extent to which COVID-19 and the resulting measures to prevent its spread will affect the Company's operations. Although there is a high degree of uncertainty around the magnitude and duration of the economic impact of COVID-19, the Company's management believes its financial position, including high levels of capital and liquidity, will allow it to successfully endure the negative economic impacts of the crisis.

### **Recent Accounting Standards**

#### *Standards Adopted in 2020*

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments remove, modify, and add certain fair value disclosure requirements based on the concepts in the FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements*. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted, including adoption in any interim period for which financial statements have *not* yet been issued. The update did *not* have a material effect on the Company's financial statements.

In March 2020, the FASB issued ASU 2020-04, "Reference Rate Reform (Topic 848) – Facilitation of the Effects of Reference Rate Reform on Financial Reporting Summary". This ASU provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. LIBOR (London Inter-bank Offered Rate) and other interbank offered rates are widely used benchmarks or reference rates in the United States and globally. With global capital markets expected to move away from LIBOR and other inter-bank offered rates toward rates that are more observable or transaction based and less susceptible to manipulation, the FASB launched a broad project in late 2018 to address potential accounting challenges expected to arise from the transition. The new guidance provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. This ASU is effective March 12, 2020 through December 31, 2022. The Company adopted this ASU on March 12, 2020. The update is *not* expected to have any material effect on the Company's financial statements.

#### *Standards Not Yet Adopted*

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This ASU purportedly requires earlier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. This ASU also 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. It further 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, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The CARES Act was passed by the United States Congress and signed into law by the President of the United States at the end of March 2020. The CARES Act states that "Notwithstanding any other provision of law, *no* insured depository institution, bank holding company, or any affiliate thereof shall be required to comply with the Financial Accounting Standards Board Accounting Standards Update No. 2016-13 ("Measurement of Credit Losses on Financial Instruments"), including the current expected credit losses methodology for estimating allowances for credit losses, during the period beginning on March 27, 2020 and ending on the earlier of: (1) the date on which the national emergency concerning the novel coronavirus disease (COVID-19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates; or (2) December 31, 2020. The Company has elected to "not comply with" ASU 2016-13 for the period specified in the CARES Act and any subsequent controlling legislation or regulation. In preparation for expiration of the period specified in the CARES Act, the Company has selected loss estimation methodologies for its allowance for credit losses, performed testing on the chosen methodologies, and determined a qualitative adjustment methodology that aligns with the requirements of the new standard. The Company has also subjected the model to *third* party validation. Based upon the aforesaid preparatory measures, upon expiration of the period specified in the CARES Act and any subsequent controlling legislation or regulation, the Company anticipates recording a cumulative-effect adjustment to retained earnings of approximately \$5.61 million in connection with adoption of the new standard, consisting of tax-effected increases in the allowance for credit losses associated with the Company's legacy loan portfolio prior to the addition of Highlands Bankshares, Inc. and the portfolio of purchased performing loans associated with Highlands of approximately \$2.89 million and \$4.44 million, respectively. The Company also anticipates making an approximate \$7.04 million adjustment as of January 1, 2020, to the opening balance of the allowance for credit losses associated with the required gross-up of purchased credit deteriorated loans from the Highlands transaction.

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740), Simplifying the Accounting for Income Taxes". This ASU simplifies the accounting for income taxes by removing certain exceptions to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted, including adoption in any interim period for which financial statements have *not* yet been issued. The update is *not* expected to have any material effect on the Company's financial statements.

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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.

**Note 2. Acquisitions*****Highlands Bankshares, Inc.***

On *September 11, 2019*, the Company entered into an Agreement and Plan of Merger with Highlands Bankshares, Inc. (“Highlands”) of Abingdon, Virginia. Under the terms of the agreement and plan of merger, each share of Highlands’ common and preferred stock outstanding immediately converted into the right to receive 0.2703 shares of the Company’s stock. The transaction was consummated the close of business *December 31, 2019*. The transaction combined *two* traditional Southwestern Virginia community banks who serve the Highlands region in Virginia, North Carolina, and Tennessee. The total purchase price for the transaction was \$86.65 million.

The Highlands transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Fair values are preliminary and subject to refinement for up to a year after the closing date of the acquisition.

<i>(Amounts in thousands)</i>	As recorded by Highlands	Fair Value Adjustments	As recorded by the Company
<b>Assets</b>			
Cash and cash equivalents	\$ 25,879	\$ -	\$ 25,879
Securities available for sale	53,732	-	53,732
Loans held for sale	263	-	263
Loans held for investment, net of allowance and mark	438,896	(11,429) ( a )	427,467
Premises and equipment	16,722	(2,317) ( b )	14,405
Other real estate	1,963	-	1,963
Other assets	25,556	2,250 ( c )	27,806
Intangible assets	-	4,490 ( d )	4,490
Total assets	<u>\$ 563,011</u>	<u>\$ (7,006)</u>	<u>\$ 556,005</u>
<b>LIABILITIES</b>			
Deposits:			
Noninterest-bearing	\$ 155,714	\$ -	\$ 155,714
Interest-bearing	346,028	1,261 ( e )	347,289
Total deposits	501,742	1,261	503,003
Long term debt	40	-	40
Other liabilities	2,938	198 ( f )	3,136
Total liabilities	504,720	1,459	506,179
Net identifiable assets acquired over (under) liabilities assumed	58,291	(8,465)	49,826
Goodwill	-	36,821	36,821
Net assets acquired over liabilities assumed	<u>\$ 58,291</u>	<u>\$ 28,356</u>	<u>\$ 86,647</u>

**Consideration:**

First Community Bankshares, Inc. common	2,792,729
Purchase price per share of the Company's common stock	\$ 31.02
Fair value of Company common stock issued	86,631
Cash paid for fractional shares	16
Fair Value of total consideration transferred	<u>\$ 86,647</u>

**Explanation of fair value adjustments:**

( a ) - Adjustment reflects the fair value adjustments of \$(14.70) million based on the Company's evaluation of the acquired loan portfolio and excludes the allowance for loan losses ("ALLL") and deferred loan fees of \$3.27 million recorded by Highlands.

( b ) - Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired premises and equipment.

( c ) - Adjustment to record the deferred tax asset related to the fair value adjustments.

( d ) - Adjustment reflects the recording of the core deposit intangible on the acquired deposit accounts.

( e ) - Adjustment reflects the fair value adjustment based on the Company's evaluation of the time deposit portfolio.

( f ) - Adjustment reflects the fair value adjustment for death benefits payable of \$320 thousand, the fair value adjustment for lease liability of \$(37) thousand and the fair value adjustment to the reserve for unfunded commitments of \$(85) thousand.

***Comparative and Pro Forma Financial Information for Acquisitions***

As the merger date was the close of business, *December 31, 2019*, Highlands had *no* earnings contribution to the *June 30, 2019* consolidated statement of income for the Company.

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The following table discloses the impact of the merger. The table also presents certain pro forma information as if Highlands had been acquired on *January 1, 2019*. These results combine the historical results of Highlands in the Company's consolidated statement of income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are *not* indicative of what would have occurred had the acquisition taken place on *January 1, 2019*.

Residual merger-related costs of \$1.89 million incurred by the Company during the *six months ended June 30, 2020*, have been excluded from the proforma information below. There were *no* residual merger expenses incurred for the *second* quarter of *2020*. *No* adjustments have been made to the pro formas to eliminate the provision for loan losses for the quarter and year ended *June 30, 2019* of Highlands in the amounts of \$836,000 and \$939,000, respectively. The Company expects to achieve further operating cost savings and other business synergies as a result of the acquisitions which are *not* reflected in the pro forma amounts below:

(Dollars in thousands)	ProForma			
	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Total revenues ( <i>net interest income plus noninterest income</i> )	\$ 33,252	\$ 37,753	\$ 68,483	\$ 74,987
Net adjusted income available to the common shareholder	\$ 8,240	\$ 10,943	\$ 17,600	\$ 22,299

### Note 3. Debt Securities

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

(Amounts in thousands)	June 30, 2020			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Agency securities	\$ 597	\$ -	\$ (4)	\$ 593
Municipal securities	61,722	769	-	62,491
Mortgage-backed Agency securities	34,195	1,088	-	35,283
Total	\$ 96,514	\$ 1,857	\$ (4)	\$ 98,367

(Amounts in thousands)	December 31, 2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Agency securities	\$ 5,038	\$ -	\$ (4)	\$ 5,034
Municipal securities	85,992	886	-	86,878
Mortgage-backed Agency securities	77,448	380	(166)	77,662
Total	\$ 168,478	\$ 1,266	\$ (170)	\$ 169,574

The following table presents the amortized cost and aggregate fair value of available-for-sale debt 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.

(Amounts in thousands)	June 30, 2020	
	Amortized Cost	Fair Value
<b>Available-for-sale debt securities</b>		
Due within one year	\$ -	\$ -
Due after one year but within five years	31,290	31,609
Due after five years but within ten years	31,029	31,475
Due after ten years	-	-
Mortgage-backed securities	62,319	63,084
Total debt securities available for sale	\$ 96,514	\$ 98,367

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

	<b>June 30, 2020</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>
<i>(Amounts in thousands)</i>						
U.S. Agency securities	\$ -	\$ -	\$ 586	\$ (4)	\$ 586	\$ (4)
Mortgage-backed Agency securities	-	-	-	-	-	-
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 586</b>	<b>\$ (4)</b>	<b>\$ 586</b>	<b>\$ (4)</b>

	<b>December 31, 2019</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>
<i>(Amounts in thousands)</i>						
U.S. Agency securities	\$ 975	\$ (4)	\$ -	\$ -	\$ 975	\$ (4)
Mortgage-backed Agency securities	8,020	(48)	8,319	(118)	16,339	(166)
<b>Total</b>	<b>\$ 8,995</b>	<b>\$ (52)</b>	<b>\$ 8,319</b>	<b>\$ (118)</b>	<b>\$ 17,314</b>	<b>\$ (170)</b>

There was 1 individual debt security in an unrealized loss position as of *June 30, 2020*, and the depreciation in value was insignificant in relation to value of the debt securities portfolio. There were 17 individual debt securities in an unrealized loss position as of *December 31, 2019*, and their combined depreciation in value represented 0.10% of the debt securities portfolio.

The Company reviews its investment portfolio quarterly for indications of other-than-temporary impairment (“OTTI”). The initial indicator of OTTI for debt securities is a decline in fair value below book value and the severity and duration of the decline. The credit-related OTTI is recognized as a charge to noninterest income and the noncredit-related OTTI is recognized in other comprehensive income (“OCI”). During the six months ended *June 30, 2020* and *2019*, the Company incurred *no* OTTI charges on debt securities. Temporary impairment on debt securities is primarily related to changes in benchmark interest rates, changes in pricing in the credit markets, and other current economic factors.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
<i>(Amounts in thousands)</i>				
Gross realized gains	\$ -	\$ 67	\$ 419	\$ 67
Gross realized losses	-	(110)	(34)	(110)
<b>Net loss on sale of securities</b>	<b>\$ -</b>	<b>\$ (43)</b>	<b>\$ 385</b>	<b>\$ (43)</b>

The carrying amount of securities pledged for various purposes totaled \$33.04 million as of *June 30, 2020*, and \$27.87 million as of *December 31, 2019*.

**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. Customer overdrafts reclassified as loans totaled \$1.41 million as of *June 30, 2020*, and \$2.20 million as of *December 31, 2019*. Deferred loan fees, net of loan costs, totaled \$6.04 million as of *June 30, 2020*, and \$4.60 million as of *December 31, 2019*. For information about off-balance sheet financing, see Note 15, “Litigation, Commitments, and Contingencies,” to the Condensed Consolidated Financial Statements of this report.

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The following table presents loans, net of unearned income, within the non-covered portfolio by loan class, as of the dates indicated:

	<b>June 30, 2020</b>		<b>December 31, 2019</b>	
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
	<i>(Amounts in thousands)</i>			
<b>Non-covered loans held for investment</b>				
<b>Commercial loans</b>				
Construction, development, and other land	\$ 52,585	2.46%	\$ 48,659	2.30%

Commercial and industrial	184,298	8.62%	142,962	6.76%
Multi-family residential	105,768	4.95%	121,840	5.76%
Single family non-owner occupied	188,389	8.82%	163,181	7.72%
Non-farm, non-residential	723,100	33.84%	727,261	34.39%
Agricultural	10,407	0.49%	11,756	0.56%
Farmland	23,662	1.11%	23,155	1.10%
Total commercial loans	1,288,209	60.29%	1,238,814	58.59%
Consumer real estate loans				
Home equity lines	99,566	4.66%	110,078	5.21%
Single family owner occupied	603,446	28.24%	620,697	29.35%
Owner occupied construction	15,311	0.72%	17,241	0.82%
Total consumer real estate loans	718,323	33.62%	748,016	35.38%
Consumer and other loans				
Consumer loans	114,551	5.36%	110,027	5.20%
Other	4,477	0.21%	4,742	0.22%
Total consumer and other loans	119,028	5.57%	114,769	5.42%
Total non-covered loans	2,125,560	99.48%	2,101,599	99.39%
Total covered loans	11,257	0.52%	12,861	0.61%
Total loans held for investment, net of unearned income	\$ 2,136,817	100.00%	\$ 2,114,460	100.00%
Loans held for sale	\$ -		\$ 263	

Commercial and industrial loan balances grew significantly compared to *December 31, 2019*. The Company began participating as a Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”) lender during the *second* quarter of 2020. At *June 30, 2020*, the PPP loans had a current balance of \$60.23 million, and were included in commercial and industrial loan balances. Deferred loan origination fees related to the PPP loans, net of deferred loan origination costs, which totaled \$2.26 million at *June 30, 2020*, were also recorded. During the *second* quarter of 2020, the Company recorded amortization of net deferred loan origination fees of \$192 thousand on PPP loans. The remaining net deferred loan origination fees will be amortized over the expected life of the respective loans, or until forgiven by the SBA, and will be recognized in net interest income.

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

	June 30, 2020	December 31, 2019
<i>(Amounts in thousands)</i>		
Covered loans		
Commercial loans		
Construction, development, and other land	\$ 27	\$ 28
Single family non-owner occupied	191	199
Non-farm, non-residential	1	3
Total commercial loans	219	230
Consumer real estate loans		
Home equity lines	8,512	9,853
Single family owner occupied	2,526	2,778
Total consumer real estate loans	11,038	12,631
Total covered loans	\$ 11,257	\$ 12,861

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The Company identifies certain purchased loans as impaired when fair values are established at acquisition and groups those 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. Effective *January 1, 2020*, the Company consolidated the insignificant PCI loans and discounts for Peoples, Waccamaw, and other acquired loans into the core loan portfolio. The only remaining PCI pools are those loans acquired in the Highlands acquisition on *December 31, 2019*.

The following table presents the recorded investment and contractual unpaid principal balance of PCI loans, by acquisition, as of the dates indicated:

	June 30, 2020		December 31, 2019	
	Recorded Investment	Unpaid Principal Balance	Recorded Investment	Unpaid Principal Balance
<i>(Amounts in thousands)</i>				
PCI Loans, by acquisition				
Peoples	\$ -	\$ -	\$ 5,071	\$ 6,431
Waccamaw	-	-	2,708	14,277
Highlands	48,193	58,181	53,116	64,096
Other acquired	-	-	352	378

Total PCI Loans \$ 48,193    \$ 58,181    \$ 61,247    \$ 85,182

The following table presents the changes in the accretable yield on PCI loans, by acquisition, during the periods indicated:

	<u>Peoples</u>	<u>Waccamaw</u>	<u>Highlands</u>	<u>Total</u>
<i>(Amounts in thousands)</i>				
Balance January 1, 2019	\$ 2,590	\$ 14,639	\$ -	\$ 17,229
Accretion	(503)	(2,151)	-	(2,654)
Reclassifications (to) from nonaccretable difference <sup>(1)</sup>	11	851	-	862
Other changes, net	111	341	-	452
Balance June 30, 2019	<u>\$ 2,209</u>	<u>\$ 13,680</u>	<u>\$ -</u>	<u>\$ 15,889</u>
Balance January 1, 2020	\$ 1,890	\$ 12,574	\$ 8,152	\$ 22,616
Accretion	-	-	(1,334)	(1,334)
Reclassifications from nonaccretable difference <sup>(1)</sup>	-	-	-	-
Other changes, net	(1,890)	(12,574)	-	(14,464)
Balance June 30, 2020	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,818</u>	<u>\$ 6,818</u>

(1) Represents changes attributable to expected loss assumptions

### 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.



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The following tables present the recorded investment of the loan portfolio, by loan 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.

	<b>June 30, 2020</b>					
<i>(Amounts in thousands)</i>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Loss</b>	<b>Total</b>
<b>Non-covered loans</b>						
<b>Commercial loans</b>						
Construction, development, and other land	\$ 35,181	\$ 14,669	\$ 2,735	\$ -	\$ -	\$ 52,585
Commercial and industrial	153,507	22,852	7,939	-	-	184,298
Multi-family residential	80,539	21,771	3,458	-	-	105,768
Single family non-owner occupied	138,578	35,590	14,207	14	-	188,389
Non-farm, non-residential	474,297	207,483	41,320	-	-	723,100
Agricultural	6,650	3,443	314	-	-	10,407
Farmland	12,933	5,452	5,277	-	-	23,662
<b>Consumer real estate loans</b>						
Home equity lines	94,694	1,397	3,475	-	-	99,566
Single family owner occupied	565,016	3,245	35,185	-	-	603,446
Owner occupied construction	14,498	202	611	-	-	15,311
<b>Consumer and other loans</b>						
Consumer loans	112,537	109	1,905	-	-	114,551
Other	4,477	-	-	-	-	4,477
<b>Total non-covered loans</b>	<b>1,692,907</b>	<b>316,213</b>	<b>116,426</b>	<b>14</b>	<b>-</b>	<b>2,125,560</b>
<b>Covered loans</b>						
<b>Commercial loans</b>						
Construction, development, and other land	-	27	-	-	-	27
Single family non-owner occupied	191	-	-	-	-	191
Non-farm, non-residential	-	-	1	-	-	1
<b>Consumer real estate loans</b>						
Home equity lines	7,803	379	330	-	-	8,512
Single family owner occupied	1,890	272	364	-	-	2,526
<b>Total covered loans</b>	<b>9,884</b>	<b>678</b>	<b>695</b>	<b>-</b>	<b>-</b>	<b>11,257</b>
<b>Total loans</b>	<b>\$ 1,702,791</b>	<b>\$ 316,891</b>	<b>\$ 117,121</b>	<b>\$ 14</b>	<b>\$ -</b>	<b>\$ 2,136,817</b>

December 31, 2019

<i>(Amounts in thousands)</i>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Loss</b>	<b>Total</b>
<b>Non-covered loans</b>						
<b>Commercial loans</b>						
Construction, development, and other land	\$ 45,781	\$ 2,079	\$ 799	\$ -	\$ -	\$ 48,659
Commercial and industrial	135,651	4,327	2,984	-	-	142,962
Multi-family residential	118,045	2,468	1,327	-	-	121,840
Single family non-owner occupied	149,916	7,489	5,776	-	-	163,181
Non-farm, non-residential	683,481	27,160	16,620	-	-	727,261
Agricultural	11,299	122	335	-	-	11,756
Farmland	17,609	4,107	1,439	-	-	23,155
<b>Consumer real estate loans</b>						
Home equity lines	106,246	2,014	1,818	-	-	110,078
Single family owner occupied	580,580	17,001	23,116	-	-	620,697
Owner occupied construction	16,341	179	721	-	-	17,241
<b>Consumer and other loans</b>						
Consumer loans	108,065	1,341	621	-	-	110,027
Other	4,742	-	-	-	-	4,742
<b>Total non-covered loans</b>	<b>1,977,756</b>	<b>68,287</b>	<b>55,556</b>	<b>-</b>	<b>-</b>	<b>2,101,599</b>
<b>Covered loans</b>						
<b>Commercial loans</b>						
Construction, development, and other land	-	28	-	-	-	28
Single family non-owner occupied	199	-	-	-	-	199
Non-farm, non-residential	-	-	3	-	-	3
<b>Consumer real estate loans</b>						
Home equity lines	7,177	2,327	349	-	-	9,853
Single family owner occupied	2,111	275	392	-	-	2,778
<b>Total covered loans</b>	<b>9,487</b>	<b>2,630</b>	<b>744</b>	<b>-</b>	<b>-</b>	<b>12,861</b>
<b>Total loans</b>	<b>\$ 1,987,243</b>	<b>\$ 70,917</b>	<b>\$ 56,300</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,114,460</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.

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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 dates indicated:

	June 30, 2020			December 31, 2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
<i>(Amounts in thousands)</i>						
Impaired loans with no related allowance						
Commercial loans						
Construction, development, and other land	\$ 877	\$ 1,101	\$ -	\$ 552	\$ 768	\$ -
Commercial and industrial	2,890	3,458	-	576	599	-
Multi-family residential	341	772	-	1,254	1,661	-
Single family non-owner occupied	5,027	5,760	-	2,652	3,176	-
Non-farm, non-residential	7,659	9,433	-	4,158	4,762	-
Agricultural	261	265	-	158	164	-
Farmland	1,815	1,907	-	1,437	1,500	-
Consumer real estate loans						
Home equity lines	1,604	1,756	-	1,372	1,477	-
Single family owner occupied	16,717	19,858	-	15,588	17,835	-
Owner occupied construction	540	548	-	648	648	-
Consumer and other loans						
Consumer loans	500	507	-	290	294	-
Total impaired loans with no allowance	38,231	45,365	-	28,685	32,884	-
Impaired loans with a related allowance						
Commercial loans						
Commercial and industrial	-	-	-	-	-	-
Multi-family residential	944	1,277	279	-	-	-
Single family non-owner occupied	-	-	-	-	-	-
Non-farm, non-residential	1,798	1,982	684	1,241	1,227	292
Farmland	-	-	-	-	-	-
Consumer real estate loans						
Home equity lines	-	-	-	-	-	-
Single family owner occupied	1,769	1,869	370	1,246	1,246	353
Consumer and other loans						
Consumer loans	-	-	-	-	-	-
Total impaired loans with an allowance	4,511	5,128	1,333	2,487	2,473	645
Total impaired loans <sup>(1)</sup>	\$ 42,742	\$ 50,493	\$ 1,333	\$ 31,172	\$ 35,357	\$ 645

(1) Total impaired loans include loans totaling \$33.59 million as of June 30, 2020, and \$24.64 million as of December 31, 2019, that do not meet the Company's evaluation threshold for individual impairment and are therefore collectively evaluated for impairment.

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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 June 30,				Six Months Ended June 30,			
	2020		2019		2020		2019	
	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
<i>(Amounts in thousands)</i>								
Impaired loans with no related allowance:								
Commercial loans								
Construction, development, and other land	\$ 7	\$ 882	\$ 5	\$ 790	\$ 15	\$ 1,091	\$ 12	\$ 795
Commercial and industrial	60	3,191	2	149	89	2,610	5	383
Multi-family residential	18	417	7	1,269	29	544	16	1,444
Single family non-owner occupied	37	5,203	28	3,237	72	4,652	56	3,116
Non-farm, non-residential	84	8,886	47	5,230	127	6,780	64	4,953
Agricultural	2	264	-	48	3	235	2	51
Farmland	15	1,835	10	1,438	36	1,698	26	1,444
Consumer real estate loans								
Home equity lines	7	1,652	7	1,484	16	1,560	14	1,446
Single family owner occupied	122	17,251	154	15,838	290	17,401	278	15,889
Owner occupied construction	4	534	2	223	10	434	4	222
Consumer and other loans								
Consumer loans	7	507	3	137	11	455	4	121
Total impaired loans with no related allowance	363	40,622	265	29,843	698	37,460	481	29,864
Impaired loans with a related allowance:								
Commercial loans								
Construction, development, and other land	-	-	-	-	-	-	-	-
Commercial and industrial	-	-	-	-	-	-	-	-
Multi-family residential	-	944	-	-	-	943	-	-
Single family non-owner occupied	-	-	-	-	-	-	-	-
Non-farm, non-residential	14	1,884	8	553	14	1,611	8	277
Farmland	-	-	-	-	-	-	-	-
Consumer real estate loans								
Home equity lines	-	-	-	-	-	-	-	-
Single family owner occupied	11	1,777	36	2,987	24	1,508	65	2,639
Owner occupied construction	-	-	-	-	-	-	-	-
Total impaired loans with a related allowance	25	4,605	44	3,540	38	4,062	73	2,916
Total impaired loans	\$ 388	\$ 45,227	\$ 309	\$ 33,383	\$ 736	\$ 41,522	\$ 554	\$ 32,780

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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>June 30, 2020</b>			<b>December 31, 2019</b>		
	<b>Non-covered</b>	<b>Covered</b>	<b>Total</b>	<b>Non-covered</b>	<b>Covered</b>	<b>Total</b>
<b>Commercial loans</b>						
Construction, development, and other land	\$ 540	\$ -	\$ 540	\$ 211	\$ -	\$ 211
Commercial and industrial	1,379	-	1,379	530	-	530
Multi-family residential	1,205	-	1,205	1,144	-	1,144
Single family non-owner occupied	3,071	-	3,071	1,286	-	1,286
Non-farm, non-residential	6,556	-	6,556	3,400	-	3,400
Agricultural	262	-	262	158	-	158
Farmland	1,106	-	1,106	713	-	713
<b>Consumer real estate loans</b>						
Home equity lines	1,069	278	1,347	753	220	973
Single family owner occupied	8,521	21	8,542	7,259	24	7,283
Owner occupied construction	321	-	321	428	-	428
<b>Consumer and other loans</b>						
Consumer loans	441	-	441	231	-	231
<b>Total nonaccrual loans</b>	<b>\$ 24,471</b>	<b>\$ 299</b>	<b>\$ 24,770</b>	<b>\$ 16,113</b>	<b>\$ 244</b>	<b>\$ 16,357</b>

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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 \$284 thousand as of *June 30, 2020*, compared to \$144 thousand as of *December 31, 2019*.

	<b>June 30, 2020</b>					
<i>(Amounts in thousands)</i>	<b>30 - 59 Days Past Due</b>	<b>60 - 89 Days Past Due</b>	<b>90+ Days Past Due</b>	<b>Total Past Due</b>	<b>Current Loans</b>	<b>Total Loans</b>
<b>Non-covered loans</b>						
<b>Commercial loans</b>						
Construction, development, and other land	\$ -	\$ 82	\$ 438	\$ 520	\$ 52,065	\$ 52,585
Commercial and industrial	411	1,525	387	2,323	181,975	184,298
Multi-family residential	961	595	944	2,500	103,268	105,768
Single family non-owner occupied	976	1,114	2,315	4,405	183,984	188,389
Non-farm, non-residential	1,853	902	4,918	7,673	715,427	723,100
Agricultural	222	13	45	280	10,127	10,407
Farmland	14	99	1,025	1,138	22,524	23,662
<b>Consumer real estate loans</b>						
Home equity lines	294	143	597	1,034	98,532	99,566
Single family owner occupied	3,181	982	3,613	7,776	595,670	603,446
Owner occupied construction	-	-	-	-	15,311	15,311
<b>Consumer and other loans</b>						
Consumer loans	848	105	240	1,193	113,358	114,551
Other	-	-	-	-	4,477	4,477
<b>Total non-covered loans</b>	<b>8,760</b>	<b>5,560</b>	<b>14,522</b>	<b>28,842</b>	<b>2,096,718</b>	<b>2,125,560</b>
<b>Covered loans</b>						
<b>Commercial loans</b>						
Construction, development, and other land	-	-	-	-	27	27
Single family non-owner occupied	-	-	-	-	191	191
Non-farm, non-residential	-	-	-	-	1	1
<b>Consumer real estate loans</b>						
Home equity lines	62	113	114	289	8,223	8,512
Single family owner occupied	21	-	-	21	2,505	2,526
<b>Total covered loans</b>	<b>83</b>	<b>113</b>	<b>114</b>	<b>310</b>	<b>10,947</b>	<b>11,257</b>
<b>Total loans</b>	<b>\$ 8,843</b>	<b>\$ 5,673</b>	<b>\$ 14,636</b>	<b>\$ 29,152</b>	<b>\$ 2,107,665</b>	<b>\$ 2,136,817</b>

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	December 31, 2019					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	Current Loans	Total Loans
<i>(Amounts in thousands)</i>						
Non-covered loans						
Commercial loans						
Construction, development, and other land	\$ 63	\$ 65	\$ 211	\$ 339	\$ 48,320	\$ 48,659
Commercial and industrial	1,913	238	507	2,658	140,304	142,962
Multi-family residential	375	-	1,144	1,519	120,321	121,840
Single family non-owner occupied	754	267	661	1,682	161,499	163,181
Non-farm, non-residential	917	1,949	3,027	5,893	721,368	727,261
Agricultural	86	164	-	250	11,506	11,756
Farmland	856	349	664	1,869	21,286	23,155
Consumer real estate loans						
Home equity lines	1,436	165	503	2,104	107,974	110,078
Single family owner occupied	7,728	2,390	3,766	13,884	606,813	620,697
Owner occupied construction	207	-	428	635	16,606	17,241
Consumer and other loans						
Consumer loans	1,735	439	202	2,376	107,651	110,027
Other	22	-	-	22	4,720	4,742
<b>Total non-covered loans</b>	<b>16,092</b>	<b>6,026</b>	<b>11,113</b>	<b>33,231</b>	<b>2,068,368</b>	<b>2,101,599</b>
Covered loans						
Commercial loans						
Construction, development, and other land	-	-	-	-	28	28
Single family non-owner occupied	-	-	-	-	199	199
Non-farm, non-residential	-	-	-	-	3	3
Consumer real estate loans						
Home equity lines	144	28	-	172	9,681	9,853
Single family owner occupied	-	50	-	50	2,728	2,778
<b>Total covered loans</b>	<b>144</b>	<b>78</b>	<b>-</b>	<b>222</b>	<b>12,639</b>	<b>12,861</b>
<b>Total loans</b>	<b>\$ 16,236</b>	<b>\$ 6,104</b>	<b>\$ 11,113</b>	<b>\$ 33,453</b>	<b>\$ 2,081,007</b>	<b>\$ 2,114,460</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 \$500 thousand are evaluated for a specific reserve based on either the collateral or net present value method, whichever is most applicable. Restructured loans under \$500 thousand are subject to the reserve calculation at the historical loss rate for classified loans. Certain 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 *June 30, 2020*, or *December 31, 2019*.

The CARES Act included a provision allowing banks to *not* apply the guidance on accounting for troubled debt restructurings to loan modifications, such as extensions or deferrals, related to COVID-19 made between *March 1, 2020* and the earlier of (i) *December 31, 2020* or (ii) *60 days* after the end of the COVID-19 national emergency. The relief can only be applied to modifications for borrowers that were *not* more than *30 days* past due as of *December 31, 2019*. The Company elected to adopt this provision of the CARES Act.

Through *June 30, 2020*, the Company had modified 3,097 loans with principal balances totaling \$436.11 million related to COVID-19 relief. Those modifications were generally short-term payment deferrals and are *not* considered TDRs based on the CARES Act. The Company's policy is to downgrade commercial loans modified for COVID-19 to Special Mention due to a higher-than-usual level of risk, which caused the significant increase in loans in that rating. Subsequent upgrade or downgrade will be on a case by case basis. The Company will consider upgrading these loans back to pass once the modification period has ended and timely contractual payments resume. Further downgrade would be based on a number of factors, including but *not* limited to additional modifications, payment performance and current underwriting.

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

<i>(Amounts in thousands)</i>	June 30, 2020			December 31, 2019		
	Nonaccrual <sup>(1)</sup>	Accruing	Total	Nonaccrual <sup>(1)</sup>	Accruing	Total
<b>Commercial loans</b>						
Construction, development, and other land	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial and industrial	-	1,498	1,498	-	-	-
Single family non-owner occupied	543	1,279	1,822	552	595	1,147
Non-farm, non-residential	-	2,425	2,425	-	307	307
<b>Consumer real estate loans</b>						
Home equity lines	-	83	83	-	115	115
Single family owner occupied	1,748	5,886	7,634	1,790	5,305	7,095
Owner occupied construction	-	218	218	-	221	221
<b>Consumer and other loans</b>						
Consumer loans	-	31	31	-	32	32
<b>Total TDRs</b>	<b>\$ 2,291</b>	<b>\$ 11,420</b>	<b>\$ 13,711</b>	<b>\$ 2,342</b>	<b>\$ 6,575</b>	<b>\$ 8,917</b>
Allowance for loan losses related to TDRs			\$ 470			\$ 353

(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:

<i>(Amounts in thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Interest income recognized	\$ 152	\$ 84	\$ 250	\$ 147

The following tables present loans modified as TDRs, by type of concession made and loan class, that were restructured during the periods indicated:

<i>(Amounts in thousands)</i>	Three Months Ended June 30,					
	2020			2019		
	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment <sup>(1)</sup>	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment <sup>(1)</sup>
<b>Below market interest rate and extended payment term</b>						
Single family non-owner occupied	-	-	-	1	80	81
Single family owner occupied	-	-	-	1	185	184
<b>Total below market interest rate and extended payment term</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2</b>	<b>265</b>	<b>265</b>
<b>Payment deferral</b>						
Commercial and industrial	1	1,106	1,106	-	-	-
Non-farm, non-residential	2	1,538	1,538	-	-	-
Single family owner occupied	1	70	54	-	-	-
<b>Total principal deferral</b>	<b>4</b>	<b>2,714</b>	<b>2,698</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total</b>	<b>4</b>	<b>\$ 2,714</b>	<b>\$ 2,698</b>	<b>2</b>	<b>\$ 265</b>	<b>\$ 265</b>

(1) Represents the loan balance immediately following modification



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	Six Months Ended June 30,					
	2020			2019		
	Total Contracts	Pre-modification Recorded Investment	Post-modificatio Recorded Investment <sup>(1)</sup>	Total Contracts	Pre-modification Recorded Investment	Post- modification Recorded Investment <sup>(1)</sup>
<i>(Amounts in thousands)</i>						
Below market interest rate						
Single family non-owner occupied	1	50	50	-	\$ -	\$ -
Total below market interest rate	1	50	50	-	-	-
Below market interest rate and extended payment term						
Single family non-owner occupied	-	-	-	3	454	432
Single family owner occupied				2	489	484
Total below market interest rate and extended payment term	-	-	-	5	943	916
Payment deferral						
Construction, development, and other land	1	63	63	-	-	-
Commercial and industrial	2	1,708	1,708	-	-	-
Single family non-owner occupied	1	529	529	-	-	-
Non-farm, non-residential	3	2,115	2,115	-	-	-
Single family owner occupied	3	742	726	1	66	45
Home equity lines	-	-	-	1	4	3
Total principal deferral	10	5,157	5,141	2	70	48
Total	11	\$ 5,207	\$ 5,191	7	\$ 1,013	\$ 964

(1) Represents the loan balance immediately following modification

Payment defaults on loans modified as TDRs restructured within the previous 12 months as of June 30, 2020, were for one loan in the amount of \$124 thousand; there were none in 2019.

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

	June 30, 2020	December 31, 2019
<i>(Amounts in thousands)</i>		
OREO	\$ 2,181	\$ 3,969
Total OREO	\$ 2,181	\$ 3,969
OREO secured by residential real estate	\$ 949	\$ 2,232
Residential real estate loans in the foreclosure process <sup>(1)</sup>	2,621	1,539

(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 following tables present the changes in the allowance for loan losses, by loan segment, during the periods indicated. There was no allowance related to PCI loans as of June 30, 2020.

	Three Months Ended June 30, 2020			
	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
	<i>(Amounts in thousands)</i>			
<b>Total allowance</b>				
Beginning balance	\$ 12,075	\$ 7,519	\$ 1,543	\$ 21,137
Provision for (recovery of) loan losses charged to operations	2,618	(221)	1,434	3,831

Charge-offs	(878)	(179)	(615)	(1,672)
Recoveries	94	175	193	462
Net charge-offs	(784)	(4)	(422)	(1,210)
Ending balance	\$ 13,909	\$ 7,294	\$ 2,555	\$ 23,758

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	Three Months Ended June 30, 2019			
	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
<i>(Amounts in thousands)</i>				
<b>Total allowance</b>				
Beginning balance	\$ 10,065	\$ 6,856	\$ 1,322	\$ 18,243
Provision for (Recovery of) loan losses charged to operations	1,263	(68)	390	1,585
Charge-offs	(1,514)	(191)	(409)	(2,114)
Recoveries	402	284	140	826
Net (charge-offs) recoveries	(1,112)	93	(269)	(1,288)
Ending balance	\$ 10,216	\$ 6,881	\$ 1,443	\$ 18,540

	Six Months Ended June 30, 2020			
	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
<i>(Amounts in thousands)</i>				
<b>Total allowance</b>				
Beginning balance	\$ 10,235	\$ 6,325	\$ 1,865	\$ 18,425
Provision for loan losses charged to operations	4,605	924	1,802	7,331
Charge-offs	(1,146)	(242)	(1,478)	(2,866)
Recoveries	215	287	366	868
Net (charge-offs) recoveries	(931)	45	(1,112)	(1,998)
Ending balance	\$ 13,909	\$ 7,294	\$ 2,555	\$ 23,758

	Six Months Ended June 30, 2019			
	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
<i>(Amounts in thousands)</i>				
<b>Total allowance</b>				
Beginning balance	\$ 10,499	\$ 6,732	\$ 1,036	\$ 18,267
Provision for loan losses charged to operations	1,157	749	899	2,805
Charge-offs	(2,006)	(950)	(780)	(3,736)
Recoveries	566	350	288	1,204
Net (charge-offs) recoveries	(1,440)	(600)	(492)	(2,532)
Ending balance	\$ 10,216	\$ 6,881	\$ 1,443	\$ 18,540

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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:

	June 30, 2020			
	Loans Individually Evaluated for Impairment	Allowance for Loans Individually Evaluated	Loans Collectively Evaluated for Impairment	Allowance for Loans Collectively Evaluated
<i>(Amounts in thousands)</i>				
<b>Commercial loans</b>				
Construction, development, and other land	\$ -	\$ -	\$ 50,846	\$ 695
Commercial and industrial	896	-	180,981	934
Multi-family residential	944	279	103,189	1,162
Single family non-owner occupied	530	-	181,314	1,706
Non-farm, non-residential	3,803	684	700,242	8,020
Agricultural	-	-	10,380	206
Farmland	-	-	20,303	225
<b>Total commercial loans</b>	<b>6,173</b>	<b>963</b>	<b>1,247,255</b>	<b>12,948</b>
<b>Consumer real estate loans</b>				
Home equity lines	-	-	106,825	752

Single family owner occupied	2,981	370	591,999	6,033
Owner occupied construction	-	-	15,311	139
Total consumer real estate loans	2,981	370	714,135	6,924
Consumer and other loans				
Consumer loans	-	-	113,603	2,553
Other	-	-	4,477	-
Total consumer and other loans	-	-	118,080	2,553
Total loans, excluding PCI loans	\$ 9,154	\$ 1,333	\$ 2,079,470	\$ 22,425

	December 31, 2019			
	Loans Individually Evaluated for Impairment	Allowance for Loans Individually Evaluated	Loans Collectively Evaluated for Impairment	Allowance for Loans Collectively Evaluated
<i>(Amounts in thousands)</i>				
Commercial loans				
Construction, development, and other land	\$ -	\$ -	\$ 30,334	\$ 245
Commercial and industrial	-	-	95,659	699
Multi-family residential	944	-	98,201	969
Single family non-owner occupied	-	-	128,520	1,323
Non-farm, non-residential	2,575	292	591,520	6,361
Agricultural	-	-	9,458	145
Farmland	-	-	16,146	201
Total commercial loans	3,519	292	969,838	9,943
Consumer real estate loans				
Home equity lines	-	-	91,999	673
Single family owner occupied	3,016	353	490,712	5,175
Owner occupied construction	-	-	16,144	124
Total consumer real estate loans	3,016	353	598,855	5,972
Consumer and other loans				
Consumer loans	-	-	99,199	1,865
Other	-	-	4,742	-
Total consumer and other loans	-	-	103,941	1,865
Total loans, excluding PCI loans	\$ 6,535	\$ 645	\$ 1,672,634	\$ 17,780

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

	June 30, 2020		December 31, 2019	
	Recorded Investment	Allowance for Loan Pools With Impairment	Recorded Investment	Allowance for Loan Pools With Impairment
<i>(Amounts in thousands)</i>				
Commercial loans				
Waccamaw commercial	\$ -	\$ -	\$ -	\$ -
Peoples commercial	-	-	4,371	-
Highlands:				
1-4 family, senior-commercial	6,736	-	4,564	-
Construction & land development	1,766	-	1,956	-
Farmland and other agricultural	3,386	-	3,722	-
Multifamily	1,635	-	1,663	-
Commercial real estate	19,056	-	21,710	-
Commercial and industrial	2,421	-	2,829	-
Other	-	-	352	-
Total commercial loans	35,000	-	41,167	-
Consumer real estate loans				
Waccamaw serviced home equity lines	-	-	2,121	-
Waccamaw residential	-	-	587	-
Highlands:				
1-4 family, junior and HELOCS	1,253	-	2,157	-
1-4 family, senior-consumer	10,992	-	13,174	-
Consumer	948	-	1,341	-
Peoples residential	-	-	700	-
Total consumer real estate loans	13,193	-	20,080	-
Total PCI loans	\$ 48,193	\$ -	\$ 61,247	\$ -

Management believed the allowance was adequate to absorb probable loan losses inherent in the loan portfolio as of *June 30, 2020*.

#### 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 in which the FDIC agrees to cover 80% of most loan and foreclosed real estate losses and reimburse certain expenses incurred in relation to those covered assets. Loss share coverage for commercial loans expired *June 30, 2017*, with recoveries ending *June 30, 2020*. Loss share coverage on single family loans will expire *June 30, 2022*. The Company’s consolidated statements of income include the expense on covered assets net of estimated reimbursements. The following table presents the changes in the FDIC indemnification asset and total covered loans and OREO for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
<i>(Amounts in thousands)</i>				
Beginning balance	\$ 2,433	\$ 4,578	\$ 2,883	\$ 5,108
Reimbursable expenses to the FDIC	-	-	-	-
Net amortization	(483)	(516)	(969)	(1,068)
(Receipts from) payments to the FDIC	(7)	(42)	29	(20)
Ending balance	<u>\$ 1,943</u>	<u>\$ 4,020</u>	<u>\$ 1,943</u>	<u>\$ 4,020</u>

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#### Note 8. Deposits

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

	June 30, 2020	December 31, 2019
<i>(Amounts in thousands)</i>		
Noninterest-bearing demand deposits	\$ 752,899	\$ 627,868
Interest-bearing deposits:		
Interest-bearing demand deposits	564,417	497,470
Money market accounts	238,957	235,712
Savings deposits	482,532	453,240
Certificates of deposit	326,558	372,821
Individual retirement accounts	132,483	142,801
Total interest-bearing deposits	1,744,947	1,702,044
Total deposits	<u>\$ 2,497,846</u>	<u>\$ 2,329,912</u>

#### Note 9. Leases

Operating leases are recorded as a right of use (“ROU”) asset and operating lease liability. The ROU asset is recorded in other assets, while the lease liability is recorded in other liabilities on the consolidated balance sheet beginning *January 1, 2019*, when the Company adopted ASU 2016-02, on a prospective basis. The ROU asset represents the right to use an underlying asset during the lease term and the lease liability represents the obligation to make lease payments arising from the lease. The ROU asset and lease liability have been recognized based on the present value of the lease payments using a discount rate that represented our incremental borrowing rate at the lease commencement date or the date of adoption of ASU 2016-02. The lease expense which is comprised of the amortization of the ROU asset and the implicit interest accreted on the lease liability, is recognized on a straight-line basis over the lease term, and is recorded in occupancy expense in the consolidated statements of income.

The Company’s current operating leases relate primarily to bank branches. The Company’s ROU asset was \$874 thousand as of *June 30, 2020* compared to \$917 thousand as of *December 31, 2019*. The operating lease liability as of *June 30, 2020* was \$950 compared to \$1.01 million as of *December 31, 2019*. The Company’s total operating leases have remaining terms of 2 – 9 years; compared with 2-10 years as of *December 31, 2019*. The *June 30, 2020* weighted average discount rate of 3.22% did not change from *December 31, 2019*.

Future minimum lease payments as of the dates indicated are as follows:

Year	June 30, 2020
<i>(Amounts in thousands)</i>	
2021	\$ 154
2022	148
2023	119
2024	119
2025 and thereafter	<u>520</u>

Total lease payments	1,060
Less: Interest	(110)
Present value of lease liabilities	<u>\$ 950</u>

<u>Year</u>	<u>December 31,</u> <u>2019</u>	
<i>(Amounts in thousands)</i>		
2020	\$	154
2021		154
2022		131
2023		119
2024 and thereafter		<u>580</u>
Total lease payments		1,138
Less: Interest		(129)
Present value of lease liabilities	\$	<u>1,009</u>

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**Note 10. Borrowings**

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

<i>(Amounts in thousands)</i>	<u>June 30, 2020</u>		<u>December 31, 2019</u>	
	<u>Balance</u>	<u>Weighted Average Rate</u>	<u>Balance</u>	<u>Weighted Average Rate</u>
Short-term borrowings				
Retail repurchase agreements	1,100	0.39%	\$ 1,601	0.14%
Total borrowings	<u>\$ 1,100</u>		<u>\$ 1,601</u>	

Repurchase agreements are secured by certain securities that remain under the Company's control during the terms of the agreements.

As of *June 30, 2020*, the Company had no long-term borrowings.

Unused borrowing capacity with the FHLB totaled \$365.67 million, net of FHLB letters of credit of \$169.04 million, as of *June 30, 2020*. As of *June 30, 2020*, the Company pledged \$939.81 million in qualifying loans to secure the FHLB borrowing capacity.

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%* that matures in *April 2021*. There was no outstanding balance on the line as of *June 30, 2020* or *December 31, 2019*.

**Note 11. Derivative Instruments and Hedging Activities**

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.

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 fair value hedges were effective as of *June 30 2020*. The following table presents the notional, or contractual, amounts and fair values of derivative instruments as of the dates indicated:

<i>(Amounts in thousands)</i>	<u>June 30, 2020</u>			<u>December 31, 2019</u>		
	<u>Notional or Contractual Amount</u>	<u>Fair Value</u>		<u>Notional or Contractual Amount</u>	<u>Fair Value</u>	
		<u>Derivative Assets</u>	<u>Derivative Liabilities</u>		<u>Derivative Assets</u>	<u>Derivativ Liabilities</u>
Derivatives designated as hedges						
Interest rate swaps	\$ 17,052	\$ -	\$ 1,322	\$ 17,432	\$ -	\$ 510
Total derivatives	<u>\$ 17,052</u>	<u>\$ -</u>	<u>\$ 1,322</u>	<u>\$ 17,432</u>	<u>\$ -</u>	<u>\$ 510</u>

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

periods indicated:

(Amounts in thousands)	Three Months Ended June 30,		Six Months Ended June 30,		Income Statement Location
	2020	2019	2020	2019	
Derivatives designated as hedges					
Interest rate swaps	\$ 80	\$ -	\$ 92	\$ -	Interest and fees on loans
Total derivative expense	\$ 80	\$ -	\$ 92	\$ -	

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#### Note 12. Employee Benefit Plans

The Company maintains *two* nonqualified domestic, noncontributory defined benefit plans (the “Benefit Plans”) for key members of senior management and non-management directors. The Company’s unfunded Benefit Plans include the Supplemental Executive Retention Plan and the Directors’ Supplemental Retirement Plan. The following table presents the components of net periodic pension cost and the effect on the consolidated statements of income for the periods indicated:

(Amounts in thousands)	Three Months Ended June 30,		Six Months Ended June 30,		Income Statement Location
	2020	2019	2020	2019	
Service cost	\$ 78	\$ 80	\$ 155	\$ 160	Salaries and employee benefits
Interest cost	89	101	178	202	Other expense
Amortization of prior service cost	50	64	100	128	Other expense
Amortization of losses	47	6	93	11	Other expense
Net periodic cost	\$ 264	\$ 251	\$ 526	\$ 501	

#### Note 13. Earnings per Share

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

(Amounts in thousands, except share and per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Net income	\$ 8,238	\$ 10,451	\$ 16,110	\$ 20,082
Weighted average common shares outstanding, basic	17,701,853	15,712,204	17,850,423	15,775,462
Dilutive effect of potential common shares				
Stock options	20,661	56,818	27,017	57,795
Restricted stock	5,786	6,298	10,885	14,241
Total dilutive effect of potential common shares	26,447	63,116	37,902	72,036
Weighted average common shares outstanding, diluted	17,728,300	15,775,320	17,888,325	15,847,498
Basic earnings per common share	\$ 0.47	\$ 0.67	\$ 0.90	\$ 1.27
Diluted earnings per common share	0.46	0.66	0.90	1.27
Antidilutive potential common shares				
Stock options	60,375	-	66,808	-
Restricted stock	34,661	-	32,159	-
Total potential antidilutive shares	95,036	-	98,967	-

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#### Note 14. Accumulated Other Comprehensive Income (Loss)

The following tables present the changes in accumulated other comprehensive income (“AOCI”), net of tax and by component, during the periods indicated:

**Three Months Ended June 30, 2020**  
**Unrealized Gains**

	(Losses) on Available- for-Sale Securities	Employee Benefit Plans	Total
<i>(Amounts in thousands)</i>			
Beginning balance	\$ 1,509	\$ (2,648)	\$ (1,139)
Other comprehensive income (loss) before reclassifications	(45)	-	(45)
Reclassified from AOCI	-	76	76
Other comprehensive income, net	(45)	76	31
Ending balance	<u>\$ 1,464</u>	<u>\$ (2,572)</u>	<u>\$ (1,108)</u>

Three Months Ended June 30, 2019			
	Unrealized Gains (Losses) on Available- for-Sale Securities	Employee Benefit Plans	Total
<i>(Amounts in thousands)</i>			
Beginning balance	\$ 677	\$ (1,410)	\$ (733)
Other comprehensive income (loss) before reclassifications	262	-	262
Reclassified from AOCI	34	56	90
Other comprehensive (loss) income, net	296	56	352
Ending balance	<u>\$ 973</u>	<u>\$ (1,354)</u>	<u>\$ (381)</u>

Six Months Ended June 30, 2020			
	Unrealized Gains (Losses) on Available- for-Sale Securities	Employee Benefit Plans	Total
<i>(Amounts in thousands)</i>			
Beginning balance	\$ 866	\$ (2,372)	\$ (1,506)
Other comprehensive income (loss) before reclassifications	902	(353)	549
Reclassified from AOCI	(304)	153	(151)
Other comprehensive income, net	598	(200)	398
Ending balance	<u>\$ 1,464</u>	<u>\$ (2,572)</u>	<u>\$ (1,108)</u>

Six Months Ended June 30, 2019			
	Unrealized Gains (Losses) on Available- for-Sale Securities	Employee Benefit Plans	Total
<i>(Amounts in thousands)</i>			
Beginning balance	\$ (285)	\$ (1,144)	\$ (1,429)
Other comprehensive income (loss) before reclassifications	1,224	(320)	904
Reclassified from AOCI	34	110	144
Other comprehensive (loss) income, net	1,258	(210)	1,048
Ending balance	<u>\$ 973</u>	<u>\$ (1,354)</u>	<u>\$ (381)</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,		Income Statement Line Item Affected
	2020	2019	2020	2019	
<i>(Amounts in thousands)</i>					
Available-for-sale securities					
Gain recognized	\$ -	\$ 43	\$ (385)	\$ 43	<i>Net loss on sale of securities</i>
Reclassified out of AOCI, before tax	-	43	(385)	43	<i>Income before income taxes</i>
Income tax expense	-	9	(81)	9	<i>Income tax expense</i>
Reclassified out of AOCI, net of tax	-	34	(304)	34	<i>Net income</i>
Employee benefit plans					
Amortization of prior service cost	\$ 50	\$ 64	\$ 100	\$ 128	<i>(1)</i>
Amortization of net actuarial benefit cost	47	6	93	11	<i>(1)</i>
					<i>Income before income</i>

Reclassified out of AOCI, before tax	97	70	193	139	<i>taxes</i>
Income tax expense	21	15	41	29	<i>Income tax expense</i>
Reclassified out of AOCI, net of tax	76	55	152	110	<i>Net income</i>
Total reclassified out of AOCI, net of tax	\$ 76	\$ 89	\$ (152)	\$ 144	<i>Net income</i>

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

## Note 15. 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 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. 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; therefore, valuations *may not* be precise. 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. 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.

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

**Available-for-Sale Debt Securities.** Debt 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. 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. Agency and Treasury securities, municipal securities, and mortgage-backed securities. 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.

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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.

**Equity Securities.** Equity securities are recorded at fair value on a recurring basis and included in other assets in the consolidated balance sheets. The Company uses Level 1 inputs to value equity securities that are traded in active markets. Equity securities that are *not* actively traded are classified in Level 2.

**Loans Held for Investment.** Loans held for investment are reported at fair value using the exit price notion, which is derived from *third*-party models. 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, by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

	<b>June 30, 2020</b>			
	<b>Total</b>	<b>Fair Value Measurements Using</b>		
	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<i>(Amounts in thousands)</i>				
Available-for-sale debt securities				
U.S. Agency securities	\$ 593	\$ -	\$ 593	\$ -
Municipal securities	62,491	-	62,491	-
Mortgage-backed Agency securities	35,283	-	35,283	-
Total available-for-sale debt securities	98,367	-	98,367	-
Equity securities	55	55	-	-
Fair value loans	12,128	-	-	12,128
Deferred compensation assets	3,790	3,790	-	-
Deferred compensation liabilities	3,790	3,790	-	-
Derivative liabilities	1,322	-	1,322	-

	<b>December 31, 2019</b>			
	<b>Total</b>	<b>Fair Value Measurements Using</b>		
	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<i>(Amounts in thousands)</i>				
Available-for-sale debt securities				
U.S. Agency securities	\$ 5,034	\$ -	\$ 5,034	\$ -
Municipal securities	86,878	-	86,878	-
Mortgage-backed Agency securities	77,662	-	77,662	-
Total available-for-sale debt securities	169,574	-	169,574	-
Equity securities	55	55	-	-
Fair value loans	10,358	-	-	10,358
Deferred compensation assets	3,990	3,990	-	-
Deferred compensation liabilities	3,990	3,990	-	-
Derivative liabilities	510	-	510	-

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*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.

*OREO.* 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 present assets measured at fair value on a nonrecurring basis, by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

	Total Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
(Amounts in thousands)				
Impaired loans, non-covered	\$ 3,178	\$ -	\$ -	\$ 3,178
OREO	2,181	-	-	2,181

	Total Fair Value	December 31, 2019 Fair Value Measurements Using		
		Level 1	Level 2	Level 3
(Amounts in thousands)				
Impaired loans, non-covered	\$ 1,828	\$ -	\$ -	\$ 1,828
OREO	3,969	-	-	3,969

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### *Quantitative Information about Level 3 Fair Value Measurements*

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

	Valuation Technique	Unobservable Input	Discount Range (Weighted Average)	
			June 30, 2020	December 31, 2019
Impaired loans, non-covered	Discounted appraisals <sup>(1)</sup>	Appraisal adjustments <sup>(2)</sup>	5% to 65%(30%)	22% to 36% (26%)
OREO	Discounted appraisals <sup>(1)</sup>	Appraisal adjustments <sup>(2)</sup>	0% to 77%(25%)	15% to 100%(8%)

(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.

*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 its 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 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.

*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 about the unfunded, contractual value of off-balance sheet financial instruments, see Note 16, "Litigation, Commitments, and Contingencies," to the Condensed Consolidated Financial Statements of this report.

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The following tables present the carrying amounts and fair values of financial instruments, by the level of valuation inputs in the fair value

hierarchy, as of the dates indicated:

<i>(Amounts in thousands)</i>	<b>June 30, 2020</b>				
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Fair Value Measurements Using</b>		
			<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 421,492	\$ 421,492	\$ 421,492	\$ -	\$ -
Debt securities available for sale	98,367	98,367	-	98,367	-
Equity securities	55	55	55	-	-
Loans held for investment, net of allowance	2,136,817	2,041,821	-	-	2,041,821
FDIC indemnification asset	1,943	810	-	-	810
Interest receivable	8,380	8,380	-	8,380	-
Deferred compensation assets	3,790	3,790	3,790	-	-
<b>Liabilities</b>					
Time deposits	459,041	462,940	-	462,940	-
Securities sold under agreements to repurchase	1,100	1,100	-	1,100	-
Interest payable	808	808	-	808	-
Derivative financial liabilities	1,322	1,322	-	1,322	-
Deferred compensation liabilities	3,790	3,790	3,790	-	-

<i>(Amounts in thousands)</i>	<b>December 31, 2019</b>				
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Fair Value Measurements Using</b>		
			<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 217,009	\$ 217,009	\$ 217,009	\$ -	\$ -
Debt securities available for sale	169,574	169,574	-	169,574	-
Equity securities	55	55	55	-	-
Loans held for sale	263	263	-	-	263
Loans held for investment, net of allowance	2,096,035	2,068,257	-	-	2,068,257
FDIC indemnification asset	2,883	1,201	-	-	1,201
Interest receivable	6,677	6,677	-	6,677	-
Deferred compensation assets	3,990	3,990	3,990	-	-
<b>Liabilities</b>					
Time deposits	515,622	512,134	-	512,134	-
Securities sold under agreements to repurchase	1,601	1,601	-	1,601	-
Interest payable	472	472	-	472	-
Derivative liabilities	510	510	-	510	-
Deferred compensation liabilities	3,990	3,990	3,990	-	-

## **Note 16. 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 consolidated 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>	<u>June 30, 2020</u>	<u>December 31, 2019</u>
Commitments to extend credit	\$ 218,577	\$ 228,716
Standby letters of credit and financial guarantees <sup>(1)</sup>	174,545	167,612
Total off-balance sheet risk	<u>393,122</u>	<u>396,328</u>
Reserve for unfunded commitments	\$ 66	\$ 66

(1) Includes FHLB letters of credit

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

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 financial condition, and 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 report and our Annual Report on Form 10-K for the year ended December 31, 2019 (the "2019 Form 10-K"). Unless the context suggests otherwise, the terms "First Community," "Company," "we," "our," and "us" refer to First Community Bankshares, Inc. and its subsidiaries as a consolidated entity.

**Executive Overview**

First Community Bankshares, Inc. (the "Company") is a financial holding company, headquartered in Bluefield, Virginia, that provides banking products and services through its wholly owned subsidiary First Community Bank (the "Bank"), a Virginia chartered bank institution. As of June 30, 2020, the Bank operated 58 branches as First Community Bank in Virginia, West Virginia, and North Carolina and as People's Community Bank, a Division of First Community Bank, in Tennessee. As of June 30, 2020, full-time equivalent employees, calculated using the number of hours worked, totaled 640. Our primary source of earnings is net interest income, the difference between interest earned on assets and interest paid on liabilities, which is supplemented by fees for services, commissions on sales, and various deposit service charges. 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. Our common stock is traded on the NASDAQ Global Select Market under the symbol, FCBC.

The Bank offers trust management, estate administration, and investment advisory services through its Trust Division and wholly owned subsidiary First Community Wealth Management ("FCWM"). The Trust Division manages inter vivos trusts and trusts under will, develops and administers employee benefit and individual retirement plans, and manages and settles estates. Fiduciary fees for these services are charged on a schedule related to the size, nature, and complexity of the account. Revenues consist primarily of investment advisory fees and commissions on assets under management and administration. As of June 30, 2020, the Trust Division and FCWM managed and administered \$1.10 billion in combined assets under various fee-based arrangements as fiduciary or agent.

**Recent Events**

In December 2019, a novel strain of coronavirus ("COVID-19") surfaced in China, and quickly spread across most of the earth, including the United States. In March 2020, President Trump declared a National Public Health Emergency. Government responses to the COVID-19 pandemic have severely restricted the level of economic activity in the Company's markets. While the financial services industry has been designated an essential business in each of the states in which the Company operates, many of the Company's customers are non-essential businesses, or are employed by non-essential businesses, and have been adversely affected by government shutdowns.

The Company's business, financial condition, and results of operations generally rely upon the ability of borrowers to repay their loans, the value of collateral underlying secured loans, and demand for loans and other financial products and services. Each of these conditions depends highly on the business environment in the primary markets where the Company operates and in the United States as a whole. The COVID-19 pandemic has, and will continue to have, a significant impact on the Company's business and operations.

To date, the COVID-19 pandemic has impacted trade, travel, employee productivity, unemployment, consumer spending, and other economic activities which has resulted in less economic activity, lower equity market valuations, significant volatility and disruption in financial markets, and has adversely affected the Company's business volume, financial condition and results of operations. However, the impact of the COVID-

19 pandemic is fluid and continues to evolve. The ultimate extent to which the COVID-19 pandemic will impact the Company's business, financial condition, and results of operations is currently uncertain and will depend on various developments, including the duration and scope of the pandemic, governmental, regulatory and private sector responses to the pandemic, the pandemic's depth of impact on national and local economies, financial market reactions, responses of the Company's customers, employees and vendors, and other factors.

In order to implement and exercise social distancing, on March 20, 2020, the Company began limiting access to branch lobbies and conducting most business through drive-through tellers and through electronic and online means. To support the health and well-being of employees, a majority of the Company's back office workforce is currently working remotely, and the Company temporarily implemented pay differential for employees not working remotely; which ended when states and localities began their phased re-opening plans. To support and assist loan customers and/or comply with guidance from regulatory authorities, the Company has deferred loan payments for many consumer and commercial customers, suspended residential property foreclosures, evictions, and involuntary automobile repossessions, and is offering fee waivers, payment deferrals, and other extraordinary assistance for automobile, mortgage, small business and personal lending customers. Future regulatory or governmental actions may require these and other types of customer-assistance measures.

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Through June 30, 2020, the Company has modified or deferred payments on a total of 3,097 loans totaling \$436.11 million in principal; 1,277 commercial loans totaling \$340.00 million in principal, 972 consumer installment loans totaling \$12.92 million in principal, 706 consumer mortgages totaling \$76.01 million in principal, and 142 home equity loans totaling \$7.18 million in principal. Deferred interest and fees for these loans will continue to accrue. However, should eventual credit losses on deferred payments occur, accrued interest income and fees would be reversed, which would negatively impact interest income in future periods. The accrued interest for these loans totaled \$702 thousand as of June 30, 2020. At this time, the Company is unable to project the materiality of any such impact. The Company proactively reached out to customers to provide guidance and assistance on loan deferrals. To date, the Company has not experienced an increase in borrowers drawing on lines of credit. Management currently believes the hotel/motel and retail loan portfolios to be at the greatest risk.

The Company is also participating in the Paycheck Protection Program ("PPP"), administered by the Small Business Administration ("SBA"), in an attempt to assist both existing customers and non-customers. Through June 30, 2020, the Company processed 758 loans with original principal balances totaling \$60.23 million through the SBA's PPP.

Management and the Board of Directors are closely monitoring the impact of the COVID-19 pandemic on results of operations and financial condition. The Company recorded a provision for loan losses of \$3.83 million in the second quarter of 2020 and \$3.50 million in the first quarter of 2020, which was significantly higher than in recent previous quarters. Management expects the provisions for loan losses for periods ending after June 30, 2020, to be materially impacted by the COVID-19 pandemic.

## **Acquisitions and Divestitures**

On September 11, 2019, the Company entered into an Agreement and Plan of Merger with Highlands Bankshares, Inc. ("Highlands" ) of Abingdon, Virginia. Under the terms of the agreement and plan of merger, each share of Highlands' common and preferred stock outstanding immediately converted into the right to receive 0.2703 shares of the Company's stock. The transaction was consummated at the close of business December 31, 2019. The transaction combined two traditional Southwestern Virginia community banks who serve the Highlands region in Virginia, North Carolina, and Tennessee. The total purchase price for the transaction was \$86.65 million.

The Highlands transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Fair values are preliminary and subject to refinement up to a year after the closing date of the acquisition.

## **Critical Accounting Estimates**

We prepare our consolidated financial statements in accordance with generally accepted accounting principles ("GAAP") in the U.S. and conform to general practices within the banking industry. Our financial position and results of operations may require management to make significant estimates and assumptions that have a material impact on our financial condition or operating performance. Due to the level of subjectivity and the susceptibility of such matters to change, actual results could differ significantly from management's assumptions and estimates. 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, when a decline in the value of an asset carried on the financial statements at fair value warrants an impairment write-down or a valuation reserve, or when 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 on quoted market prices, when available, or third-party sources. When quoted prices or 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 accounting policies are described in detail in Note 1, "Basis of Presentation," of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2020, and in Note 1, "Basis of Presentation and Significant Accounting Policies," of the Notes to Consolidated Financial Statements in Part II, Item 8 of our 2019 Form 10-K. Our critical accounting estimates are detailed in the "Critical Accounting Estimates" section in Part II, Item 7 of our 2019 Form 10-K.

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**Performance Overview**

Highlights of our results of operations for the three and six months ended June 30, 2020, and financial condition as of June 30, 2020, include the following:

- Diluted earnings per share was \$0.46 for the quarter and \$0.90 for the six months .
- Current quarter earnings include a loan loss provision of \$3.83 million, an increase of \$2.25 million over second quarter of 2019. Coupled with the provision of the first quarter of 2020, the provision had the cumulative effect of increasing loan loss reserves \$5.33 million for the six month period to recognize the impact of the coronavirus slowdown.
- Despite the significant increase in loan loss provision, return on average assets remained strong at 1.15% for both the second quarter and the six month period. The significant increase in loan loss provision over previous quarterly provisions reduced return on average assets for the quarter by 0.24%.
- Net interest margin decreased 50 basis points to 4.22% compared to the same quarter of 2019. Net interest margin decreased 20 basis points to 4.46% for the six months compared to the same period of 2019. Both decreases are reflective of the current historically low interest rate environment.
- As of June 30, 2020, the Company continues to significantly exceed regulatory “well capitalized” targets, as well as all capital targets of its capital management plan. The Company completed its previous share repurchase authorization in the first quarter of 2020, prior to the onset of the current coronavirus pandemic, which completed a strategic objective of acquiring 6.6 million shares, returning over \$149 million in surplus capital to shareholders. In light of the uncertain economic forecast, the Company has temporarily delayed consideration of a new share repurchase authorization to preserve and further accumulate surplus capital.
- Total deposits have grown \$167.93 million, or 7.21%, during 2020 with \$125.03 million of the increase coming in interest free categories.

**Results of Operations***Net Income*

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

<i>(Amounts in thousands, except per share data)</i>	<u>Three Months Ended</u>		<u>Three Months Ended</u>		<u>Six Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>Increase</u>		<u>June 30,</u>		<u>Increase</u>	
	<u>2020</u>	<u>2019</u>	<u>(Decrease)</u>	<u>% Change</u>	<u>2020</u>	<u>2019</u>	<u>(Decrease)</u>	<u>% Change</u>
Net income	\$ 8,238	\$ 10,451	\$ (2,213)	-21.18%	\$ 16,110	\$ 20,082	\$ (3,972)	-19.78%
Basic earnings per common share	0.47	0.67	(0.20)	-29.85%	0.90	1.27	(0.37)	-29.13%
Diluted earnings per common share	0.46	0.66	(0.20)	-30.30%	0.90	1.27	(0.37)	-29.13%
Return on average assets	1.15%	1.89%	-0.74%	-39.15%	1.15%	1.82%	-0.67%	-36.81%
Return on average common equity	7.97%	12.57%	-4.60%	-36.60%	7.73%	12.17%	-4.44%	-36.48%

*Three-Month Comparison.* Net income decreased \$2.21 million in the second quarter of 2020 largely due to a \$2.25 million increase in the provision for loan losses as a result of increasing the reserve to recognize the impact of the coronavirus slowdown. Additional decreases resulted from increases in salaries and employee benefits of \$1.86 million reflective of the addition of Highlands, as well as expenses arising from the implementation of a pay differential related to COVID-19 which ended May 31, 2020. Pandemic shutdowns and stay-at-home orders had a significant negative impact on deposit service charges resulting in a decrease of \$1.14 million in income. Results for second quarter 2019 included one-time litigation settlements of \$2.03 million. These decreases were offset by an increase of \$3.35 million in net interest income that is reflective of the addition of Highlands; as well as an increase of \$1.43 million in various other noninterest income categories.

*Six-Month Comparison.* Net income decreased \$3.97 million in the first six months of 2020 due to a \$4.53 million increase in the provision for loan losses as a result of increasing the reserve to recognize the impact of the coronavirus slowdown as noted above. Additional decreases resulted from an increase in salaries and employee benefits of \$4.08 million which was reflective of the addition of Highlands as well as expenses arising from the implementation of the pay differential related to COVID-19 which ended May 31, 2020. 2019 included litigation settlements received of \$3.70 million. These decreases were offset by an increase of \$8.85 million in net interest income that is reflective of the of Highlands acquisition.

*Net Interest Income*

Net interest income, our largest contributor to earnings, is analyzed on a fully taxable equivalent (“FTE”) basis, a non-GAAP financial measure. For additional information, see “Non-GAAP Financial Measures” below. The following tables present the consolidated average balance sheets and net interest analysis on a FTE basis for the dates indicated:

**AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS (Unaudited)**

(Amounts in thousands)	Three Months Ended June 30,					
	2020			2019		
	Average Balance	Interest <sup>(1)</sup>	Average Yield/Rate <sup>(1)</sup>	Average Balance	Interest <sup>(1)</sup>	Average Yield/Rate <sup>(1)</sup>
<b>Assets</b>						
Earning assets						
Loans <sup>(2)(3)</sup>	\$ 2,129,513	\$ 27,040	5.11%	\$ 1,721,392	\$ 22,772	5.31%
Securities available for sale	103,378	839	3.26%	126,153	1,068	3.40%
Interest-bearing deposits	293,791	81	0.11%	125,759	766	2.44%
Total earning assets	2,526,682	27,960	4.45%	1,973,304	24,606	5.00%
Other assets	356,913			248,270		
Total assets	<u>\$ 2,883,595</u>			<u>\$ 2,221,574</u>		
<b>Liabilities and stockholders' equity</b>						
Interest-bearing deposits						
Demand deposits	\$ 547,445	\$ 98	0.07%	\$ 454,246	\$ 77	0.07%
Savings deposits	707,298	240	0.14%	504,854	192	0.15%
Time deposits	465,212	1,107	0.96%	429,469	1,123	1.05%
Total interest-bearing deposits	1,719,955	1,445	0.34%	1,388,569	1,392	0.40%
Borrowings						
Retail repurchase agreements	1,244	1	0.14%	3,024	1	0.13%
Total borrowings	1,244	1	0.14%	3,024	1	0.13%
Total interest-bearing liabilities	1,721,199	1,446	0.34%	1,391,593	1,393	0.40%
Noninterest-bearing demand deposits	711,174			468,782		
Other liabilities	35,467			27,604		
Total liabilities	2,467,840			1,887,979		
Stockholders' equity	415,755			333,595		
Total liabilities and stockholders' equity	<u>\$ 2,883,595</u>			<u>\$ 2,221,574</u>		
Net interest income, FTE <sup>(1)</sup>		<u>\$ 26,514</u>			<u>\$ 23,213</u>	
Net interest rate spread			<u>4.11%</u>			<u>4.60%</u>
Net interest margin, FTE <sup>(1)</sup>			<u>4.22%</u>			<u>4.72%</u>

- (1) Interest income and average yield/rate are presented on a FTE, non-GAAP, basis using the federal statutory income tax rate of 21%.  
(2) Nonaccrual loans are included in the average balance; however, no related interest income is recorded during the period of nonaccrual.  
(3) Interest on loans includes non-cash and accelerated purchase accounting accretion of \$1.50 million and \$1.39 million for the three months ended June 30, 2020 and 2019, respectively.

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**AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS (Unaudited)**

(Amounts in thousands)	Six Months Ended June 30,					
	2020			2019		
	Average Balance	Interest <sup>(1)</sup>	Average Yield/Rate <sup>(1)</sup>	Average Balance	Interest <sup>(1)</sup>	Average Yield/Rate <sup>(1)</sup>
<b>Assets</b>						
Earning assets						
Loans <sup>(2)(3)</sup>	\$ 2,105,323	\$ 55,145	5.27%	\$ 1,743,141	\$ 45,008	5.21%
Securities available for sale	119,744	1,899	3.19%	135,914	2,299	3.42%
Securities held to maturity	-	-	-	6,140	45	1.48%
Interest-bearing deposits	228,636	616	0.53%	90,423	1,104	2.45%
Total earning assets	2,453,703	57,660	4.73%	1,975,618	48,456	4.95%
Other assets	355,280			248,118		
Total assets	<u>\$ 2,808,983</u>			<u>\$ 2,223,736</u>		
<b>Liabilities and stockholders' equity</b>						
Interest-bearing deposits						
Demand deposits	\$ 525,024	\$ 188	0.07%	\$ 450,655	\$ 114	0.05%
Savings deposits	693,477	654	0.19%	503,075	367	0.15%
Time deposits	475,149	2,429	1.03%	433,936	2,216	1.03%

Total interest-bearing deposits	1,693,650	3,271	0.39%	1,387,666	2,697	0.39%
<b>Borrowings</b>						
Retail repurchase agreements	1,346	3	0.39%	3,141	2	0.14%
Wholesale repurchase agreements	-	-	-	7,597	119	3.17%
FHLB advances and other borrowings	72	1	2.23%	-	-	-
<b>Total borrowings</b>	<b>1,418</b>	<b>4</b>	<b>0.57%</b>	<b>10,738</b>	<b>121</b>	<b>2.27%</b>
Total interest-bearing liabilities	1,695,068	3,275	0.39%	1,398,404	2,818	0.41%
Noninterest-bearing demand deposits	655,906			464,299		
Other liabilities	38,820			28,245		
<b>Total liabilities</b>	<b>2,389,794</b>			<b>1,890,948</b>		
Stockholders' equity	419,189			332,788		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 2,808,983</b>			<b>\$ 2,223,736</b>		
Net interest income, FTE <sup>(1)</sup>		<u>\$ 54,385</u>			<u>\$ 45,638</u>	
Net interest rate spread			<u>4.34%</u>			<u>4.54%</u>
Net interest margin, FTE <sup>(1)</sup>			<u>4.46%</u>			<u>4.66%</u>

- (1) Interest income and average yield/rate are presented on a FTE, non-GAAP, basis using the federal statutory income tax rate of 21%.  
(2) Nonaccrual loans are included in the average balance; however, no related interest income is recorded during the period of nonaccrual.  
(3) Interest on loans includes non-cash purchase accounting accretion of \$3.46 million and \$2.15 million for the six months ended June 30, 2020 and 2019, respectively.

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The following table presents the impact to net interest income on a FTE basis due to 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:

<i>(Amounts in thousands)</i>	<b>Three Months Ended June 30, 2020 Compared to 2019 Dollar Increase (Decrease) due to</b>				<b>Six Months Ended June 30, 2020 Compared to 2019 Dollar Increase (Decrease) due to</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Rate/ Volume</b>	<b>Total</b>	<b>Volume</b>	<b>Rate</b>	<b>Rate/ Volume</b>	<b>Total</b>
<b>Interest earned on<sup>(1)</sup></b>								
Loans	\$ 10,798	\$ (1,828)	\$ (4,702)	\$ 4,268	\$ 9,352	\$ 565	\$ 220	\$ 10,137
Securities available-for-sale	(386)	(88)	245	(229)	(274)	(157)	31	(400)
Securities held-to-maturity	-	-	-	-	(45)	(45)	45	(45)
Interest-bearing deposits with other banks	2,047	(1,463)	(1,269)	(685)	1,681	(863)	(1,306)	(488)
<b>Total interest earning assets</b>	<b>12,459</b>	<b>(3,379)</b>	<b>(5,726)</b>	<b>3,354</b>	<b>10,714</b>	<b>(500)</b>	<b>(1,010)</b>	<b>9,204</b>
<b>Interest paid on<sup>(1)</sup></b>								
Demand deposits	32	9	(20)	21	19	48	7	74
Savings deposits	154	(41)	(65)	48	139	108	40	287
Time deposits	187	(202)	(1)	(16)	210	2	1	213
Retail repurchase agreements	(1)	-	1	-	(1)	4	(2)	1
Wholesale repurchase agreements	-	-	-	-	(119)	(120)	120	(119)
FHLB advances and other borrowings	-	-	1	1	-	-	1	1
<b>Total interest-bearing liabilities</b>	<b>372</b>	<b>(234)</b>	<b>(84)</b>	<b>54</b>	<b>248</b>	<b>42</b>	<b>167</b>	<b>457</b>
<b>Change in net interest income<sup>(1)</sup></b>	<b>\$ 12,087</b>	<b>\$ (3,145)</b>	<b>\$ (5,642)</b>	<b>\$ 3,300</b>	<b>\$ 10,466</b>	<b>\$ (542)</b>	<b>\$ (1,177)</b>	<b>\$ 8,747</b>

- (1) FTE basis based on the federal statutory rate of 21%.

*Three-Month Comparison.* Net interest income comprised 79.21% of total net interest and noninterest income in the second quarter of 2020 compared to 72.66% in the same quarter of 2019. Net interest income on a GAAP basis increased \$3.35 million, or 14.57%, compared to an increase of \$3.30 million, or 14.22%, on a FTE basis. The net interest margin on a FTE basis decreased 50 basis points and the net interest spread on a FTE basis decreased 49 basis points. The decrease in the net interest margin and the net interest spread are primarily attributable to the current historically low interest rate environment.

Average earning assets increased \$553.38 million, or 28.04%, primarily due to an increase in average loans as well as an increase in interest-bearing deposits. Average loans increased \$408.12 million which was primarily due to the addition of Highlands. The yield on earning assets decreased 55 basis points or 11.00%, primarily due to the historically low rate environment. The average loan to deposit ratio decreased to



87.59% from 92.68% in the same quarter of 2019. Non-cash accretion income increased \$112 thousand, or 8.06%, due to the addition of loans from the Highlands acquisition.

Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, increased \$329.61 million, or 23.69%, primarily due to an increase in interest-bearing deposits. The yield on interest-bearing liabilities decreased 6 basis points. Average interest-bearing deposits increased \$331.39 million, or 23.87%, which was driven by the December 31, 2019 Highlands acquisition with increases in average savings deposits of \$202.44 million, or 40.10%, interest-bearing demand of \$93.20 million, or 20.52%, and time deposits of \$35.74 million, or 8.32%

*Six-Month Comparison.* Net interest income comprised 78.88% of total net interest and noninterest income for the first six months of 2020 compared to 72.98% in the same period of 2019. Net interest income on a GAAP basis increased \$8.85 million, or 19.58%, compared to an increase of \$8.75 million, or 19.17%, on a FTE basis. The net interest margin on a FTE basis decreased 20 basis points and the net interest spread on a FTE basis decreased 20 basis points as well. The decrease in the net interest margin and the net interest spread are primarily attributable to the historically low rate environment experienced over the past quarter.

Average earning assets increased \$478.09 million, or 24.20%, primarily due to an increase in loans and overnight funds sold. The yield on earning assets decreased 22 basis points as the yields in interest-bearing deposits and the available-for-sale investment portfolio decreased. Average loans increased \$362.18 million, or 20.78%, and the average loan to deposit ratio decreased to 89.61% from 94.12% in the same period of 2019. Non-cash accretion income increased \$1.30 million, or 60.40%, due to the addition of loans from the Highlands acquisition.

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Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, increased \$296.66 million, or 21.21%, primarily due to an increase in interest-bearing deposits. The yield on interest-bearing liabilities decreased 2 basis points or 4.88%. Average borrowings decreased \$9.32 million, or 86.79%, largely due to a decrease in average wholesale repurchase agreements of \$7.60 million. The decrease resulted from the payoff of a \$25 million wholesale repurchase agreement in the first quarter of 2019. Average interest-bearing deposits increased \$305.98 million, or 22.05%, which was driven by the December 2019 acquisition of Highlands, resulting in increases of \$190.40 million in savings, \$74.37 million in interest-bearing demand, and \$41.21 million in time deposits.

### *Provision for Loan Losses*

*Three-Month Comparison.* The provision charged to operations increased \$2.25 million, or 141.70%, to \$3.83 million in the second quarter of 2020 compared to the same quarter of 2019. The increase in the provision was primarily due to the impact of the the coronavirus slowdown. For additional information, see “Allowance for Loan Losses” in the “Financial Condition” section below.

*Six-Month Comparison.* The provision charged to operations increased \$4.53 million, or 161.35%, to \$7.33 million for the first six months of 2020 compared to the same period of 2019. The provision had the effect of increasing loan loss reserves \$5.33 million to recognize the impact of the coronavirus slowdown. For additional information, 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				Six Months Ended			
	June 30,		Increase (Decrease)	% Change	June 30,		Increase (Decrease)	% Change
2020	2019	2020			2019			
<i>(Amounts in thousands)</i>								
Wealth management	\$ 854	\$ 884	\$ (30)	-3.39%	\$ 1,698	\$ 1,629	\$ 69	4.24%
Service charges on deposits	2,560	3,699	(1,139)	-30.79%	6,291	7,107	(816)	-11.48%
Other service charges and fees	2,617	2,129	488	22.92%	4,848	4,178	670	16.04%
Net gain on sale of securities	-	(43)	43	-	385	(43)	428	-
Net FDIC indemnification asset amortization	(483)	(516)	33	-6.40%	(969)	(1,068)	99	-9.27%
Other income/litigation settlements	-	2,025	(2,025)	-	-	3,700	(3,700)	-
Other operating income	1,365	471	894	189.81%	2,209	1,226	983	80.18%
Total noninterest income	<u>\$ 6,913</u>	<u>\$ 8,649</u>	<u>\$ (1,736)</u>	<u>-20.07%</u>	<u>\$ 14,462</u>	<u>\$ 16,729</u>	<u>\$ (2,267)</u>	<u>-13.55%</u>

*Three-Month Comparison.* Noninterest income comprised 20.79% of total net interest and noninterest income in the second quarter of 2020 compared to 27.34% in the same quarter of 2019. Noninterest income decreased \$1.74 million, or 20.07%. The decrease was primarily due to \$2.03 million received from litigation settlements in the second quarter of 2019. In addition, service charges on deposits decreased \$1.14 million due to the impact of pandemic shutdowns and stay-at-home orders. These amounts were offset by increases in other service charges and fees and other operating income of \$1.38 million. The increases were primarily driven by an increase in net interchange income.

*Six-Month Comparison.* Noninterest income comprised 21.12% of total net interest and noninterest income for the first six months of 2020 compared to 27.02% in the same period of 2019. Noninterest income decreased \$2.27 million, or 13.55%, primarily due to \$3.70 million received from litigation settlements in 2019. In addition, service charges on deposits decreased \$816 thousand primarily as a result of the second quarter

effects of the pandemic shutdowns. These decreases were offset by increases in other operating income, other service charges and fees, and the net gain on sale of securities. Other Operating income increased \$983 thousand or 80.18% and was primarily driven by third party incentives associated with debit cards and demand deposit accounts. Other service charges and fees increased \$670 thousand, or 16.04%, primarily due to an increase of \$734 thousand in net interchange income. Excluding the impact from litigation settlements, noninterest income increased \$1.43 million, or 11.00%, for the first six months of 2020.

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*Noninterest Expense*

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

	<b>Three Months Ended</b>		<b>Increase</b>	<b>%</b>	<b>Six Months Ended</b>		<b>Increase</b>	<b>%</b>
	<b>June 30,</b>				<b>June 30,</b>			
	<b>2020</b>	<b>2019</b>	<b>(Decrease)</b>	<b>Change</b>	<b>2020</b>	<b>2019</b>	<b>(Decrease)</b>	<b>Change</b>
<i>(Amounts in thousands)</i>								
Salaries and employee benefits	\$ 11,015	\$ 9,153	\$ 1,862	20.34%	\$ 22,401	\$ 18,319	\$ 4,082	22.28%
Occupancy expense	1,275	1,082	193	17.84%	2,590	2,235	355	15.88%
Furniture and equipment expense	1,316	1,062	254	23.92%	2,700	2,095	605	28.88%
Service fees	1,329	1,231	98	7.96%	2,852	2,261	591	26.14%
Advertising and public relations	475	513	(38)	-7.41%	987	1,037	(50)	-4.82%
Professional fees	307	328	(21)	-6.40%	540	742	(202)	-27.22%
Amortization of intangibles	360	249	111	44.58%	721	495	226	45.66%
FDIC premiums and assessments	33	150	(117)	-78.00%	33	318	(285)	-89.62%
Merger expense	-	-	-	-	1,893	-	1,893	-
Other operating expense	2,803	2,883	(80)	-2.77%	5,860	5,934	(74)	-1.25%
<b>Total noninterest expense</b>	<b>\$ 18,913</b>	<b>\$ 16,651</b>	<b>\$ 2,262</b>	<b>13.58%</b>	<b>\$ 40,577</b>	<b>\$ 33,436</b>	<b>\$ 7,141</b>	<b>21.36%</b>

*Three-Month Comparison.* Noninterest expense increased \$2.26 million, or 13.58%, in the second quarter of 2020 compared to the same quarter of 2019. The increase was largely due to an increase in salaries and benefits of \$1.86 million primarily attributable to the addition of Highlands employees as well as an increase due to temporary COVID-19 related expenses for pay differential made to employees continuing to work at branch and back-office locations.

*Six-Month Comparison.* Noninterest expense increased \$7.14 million, or 21.36%, in the first six months of 2020 compared to the same period of 2019. The increase was primarily due to an increase in salaries and benefits of \$4.08 million, or 22.28% which was largely due to the addition of Highlands employees. In addition, the Company incurred \$1.89 million in residual merger expenses during the first quarter of 2020 related to the Highlands acquisition. Occupancy and furniture and equipment expense increased a combined total of \$960 thousand and was primarily driven by the addition of branch locations acquired in the Highlands transaction.

*Income Tax Expense*

The Company's effective tax rate, income tax as a percent of pre-tax income, may vary significantly from the statutory rate due to permanent differences and available tax credits. Permanent differences are income and expense items excluded by law in the calculation of taxable income. The Company's most significant permanent differences generally include interest income on municipal securities and increases in the cash surrender value of life insurance policies.

*Three-Month Comparison.* Income tax expense decreased \$681 thousand, or 23.08%, primarily due to the decrease in pre-tax earnings. The effective tax rate decreased to 21.60% in the second quarter of 2020 from 22.02% in the same quarter of 2019.

*Six-Month Comparison.* Income tax expense decreased \$1.12 million, or 20.00%, and the effective tax rate decreased to 21.70% in the second quarter of 2019 from 21.75% in the same quarter of 2019.

*Non-GAAP Financial Measures*

In addition to financial statements prepared in accordance with GAAP, we use certain non-GAAP financial measures that management believes provide investors with important information useful in understanding our operational performance and comparing our financial measures with other financial institutions. The non-GAAP financial measure presented in this report includes net interest income on a FTE basis. 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 FTE basis adjusts for the tax benefits of income from certain tax exempt loans and investments using the federal statutory rate of 21%. While we believe certain non-GAAP financial measures enhance understanding of our business and performance, they are supplemental and not a substitute for, or more important than, financial measures prepared on a GAAP basis. Our non-GAAP financial measures may not be comparable to those reported by other financial institutions. The reconciliations of non-GAAP to GAAP measures are presented below.

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
<i>(Amounts in thousands)</i>				
Net interest income, GAAP	\$ 26,339	\$ 22,989	\$ 54,021	\$ 45,175
FTE adjustment <sup>(1)</sup>	174	224	364	463
Net interest income, FTE	<u>26,513</u>	<u>23,213</u>	<u>54,385</u>	<u>45,638</u>
Net interest margin, GAAP	4.19%	4.67%	4.43%	4.61%
FTE adjustment <sup>(1)</sup>	0.03%	0.04%	0.03%	0.05%
Net interest margin, FTE	<u>4.22%</u>	<u>4.72%</u>	<u>4.46%</u>	<u>4.66%</u>

### Financial Condition

Total assets as of June 30, 2020, increased \$150.22 million, or 5.37% from December 31, 2019. The increase in assets was primarily driven by a increase in overnight funds of \$213.68 million, or 144.38%. In addition, total liabilities as of June 30, 2020, increased \$163.21 million, or 6.89% from December 31, 2019. The increase in liabilities was primarily the result of an increase in total deposits of \$167.93 million, or 7.21%.

### 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 debt securities as of June 30, 2020, decreased \$71.21 million, or 41.99%, compared to December 31, 2019. The decrease was primarily due to the sale of \$51.03 million in securities in the first quarter. The market value of debt securities available for sale as a percentage of amortized cost was 101.92.% as of June 30, 2020, compared to 100.65% as of December 31, 2019.

Investment securities are reviewed quarterly for possible other-than-temporary impairment (“OTTI”) charges. We recognized no OTTI charges in earnings associated with debt securities for the three and six months ended June 30, 2020 or 2019. For additional information, see Note 2, “Debt 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 June 30, 2020, increased \$22.36 million, or 1.06%, compared to December 31, 2019. Covered loans decreased \$1.60 million, or 12.47%, as the covered Waccamaw portfolio continues to pay down. For additional information, see Note 4, “Loans,” to the Condensed Consolidated Financial Statements in Item 1 of this report.

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

	<b>June 30, 2020</b>		<b>December 31, 2019</b>		<b>June 30, 2019</b>	
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
<i>(Amounts in thousands)</i>						
Non-covered loans held for investment						
Commercial loans						
Construction, development, and other land	\$ 52,585	2.46%	\$ 48,659	2.30%	\$ 62,155	3.61%
Commercial and industrial	184,298	8.62%	142,962	6.76%	92,304	5.36%
Multi-family residential	105,768	4.95%	121,840	5.76%	100,569	5.84%
Single family non-owner occupied	188,389	8.82%	163,181	7.72%	139,180	8.11%
Non-farm, non-residential	723,100	33.84%	727,261	34.39%	596,163	34.64%
Agricultural	10,407	0.49%	11,756	0.56%	9,462	0.55%
Farmland	23,662	1.11%	23,155	1.10%	17,322	1.01%
Total commercial loans	<u>1,288,209</u>	<u>60.29%</u>	<u>1,238,814</u>	<u>58.59%</u>	<u>1,017,155</u>	<u>59.12%</u>
Consumer real estate loans						

Home equity lines	99,566	4.66%	110,078	5.21%	88,094	5.12%
Single family owner occupied	603,446	28.24%	620,697	29.35%	493,555	28.67%
Owner occupied construction	15,311	0.72%	17,241	0.82%	13,755	0.80%
<b>Total consumer real estate loans</b>	<b>718,323</b>	<b>33.62%</b>	<b>748,016</b>	<b>35.38%</b>	<b>595,404</b>	<b>34.59%</b>
<b>Consumer and other loans</b>						
Consumer loans	114,551	5.36%	110,027	5.20%	88,352	5.13%
Other	4,477	0.21%	4,742	0.22%	4,497	0.26%
<b>Total consumer and other loans</b>	<b>119,028</b>	<b>5.57%</b>	<b>114,769</b>	<b>5.42%</b>	<b>92,849</b>	<b>5.39%</b>
Total non-covered loans	2,125,560	99.48%	2,101,599	99.39%	1,705,408	99.10%
Total covered loans	11,257	0.52%	12,861	0.61%	15,520	0.90%
Total loans held for investment, net of unearned income	2,136,817	100.00%	2,114,460	100.00%	1,720,928	100.00%
Less: allowance for loan losses	23,758		18,425		18,540	
Total loans held for investment, net of unearned income and allowance	<u>\$ 2,113,059</u>		<u>\$ 2,096,035</u>		<u>\$ 1,702,388</u>	
Loans held for sale	<u>\$ -</u>		<u>\$ 263</u>		<u>\$ -</u>	

Commercial and industrial loan balances grew significantly compared to December 31, 2019. During the second quarter, we began participating as a Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”) lender. At June 30, 2020, the PPP loans had a current balance of \$60.23 million, and were included in commercial and industrial loan balances. Deferred loan origination fees related to the PPP loans, net of deferred loan origination costs, which totaled \$2.26 million at June 30, 2020, were also recorded. During the second quarter of 2020, we recorded amortization of net deferred loan origination fees of \$192 thousand on PPP loans. The remaining net deferred loan origination fees will be amortized over the expected life of the respective loans, or until forgiven by the SBA, and will be recognized in net interest income.

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

<i>(Amounts in thousands)</i>	June 30, 2020		December 31, 2019		June 30, 2019	
	Amount	Percent	Amount	Percent	Amount	Percent
<b>Commercial loans</b>						
Construction, development, and other land	\$ 27	0.24%	\$ 28	0.22%	\$ 31	0.20%
Single family non-owner occupied	191	1.70%	199	1.55%	224	1.44%
Non-farm, non-residential	1	0.01%	3	0.02%	5	0.03%
<b>Total commercial loans</b>	<b>219</b>	<b>1.95%</b>	<b>230</b>	<b>1.79%</b>	<b>260</b>	<b>1.67%</b>
<b>Consumer real estate loans</b>						
Home equity lines	8,512	75.61%	9,853	76.61%	12,254	78.96%
Single family owner occupied	2,526	22.44%	2,778	21.60%	3,006	19.37%
<b>Total consumer real estate loans</b>	<b>11,038</b>	<b>98.05%</b>	<b>12,631</b>	<b>98.21%</b>	<b>15,260</b>	<b>98.33%</b>
<b>Total covered loans</b>	<b><u>\$ 11,257</u></b>	<b>100.00%</b>	<b><u>\$ 12,861</u></b>	<b>100.00%</b>	<b><u>\$ 15,520</u></b>	<b>100.00%</b>

## *Commercial Loans Modified Under CARES Act*

The following table details the balance of commercial loans modified under provisions of the CARES Act as of June 30, 2020.

<i>(unaudited, in thousands)</i>	Total Balance	Percent Modified
Construction, development, and other land	\$ 14,377	27.33%
Commercial and industrial	25,584	13.88%
Multi-family residential	22,021	20.82%
Single family non-owner occupied	39,135	20.75%
Commercial Real Estate - Hotel/Motel	92,940	89.75%
Commercial Real Estate - Retail Strip Centers	19,740	38.17%
Commercial Real Estate - Other	116,871	20.58%
Agricultural	3,464	33.29%
Farmland	5,865	24.79%
<b>Total commercial modifications</b>	<b><u>\$ 339,997</u></b>	<b>26.39%</b>

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### *Risk Elements*

We seek to mitigate credit risk by following specific underwriting practices and by ongoing monitoring of our loan portfolio. Our underwriting practices include the analysis of borrowers' prior credit histories, financial statements, tax returns, and cash flow projections; valuation of collateral based on independent appraisers' reports; and verification of liquid assets. We believe our underwriting criteria are appropriate for the various loan types we offer; however, losses may occur that exceed the reserves established in our allowance for loan losses. 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 \$4.00 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. 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. For additional information, see Note 5, "Credit Quality," to the Condensed Consolidated Financial Statements in Item 1 of this report.

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The following table presents the components of nonperforming assets and related information as of the periods indicated:

	<u>June 30, 2020</u>	<u>December 31, 2019</u>	<u>June 30, 2019</u>
<i>(Amounts in thousands)</i>			
<b>Non-covered nonperforming</b>			
Nonaccrual loans	\$ 24,471	\$ 16,113	\$ 16,368
Accruing loans past due 90 days or more	284	144	37
TDRs <sup>(1)</sup>	598	720	821
Total nonperforming loans	<u>25,353</u>	<u>16,977</u>	<u>17,226</u>
Non-covered OREO	2,181	3,969	3,810
Total non-covered nonperforming assets	<u>\$ 27,534</u>	<u>\$ 20,946</u>	<u>\$ 21,036</u>
<b>Covered nonperforming</b>			
Nonaccrual loans	\$ 299	\$ 244	\$ 203
Total nonperforming loans	<u>299</u>	<u>244</u>	<u>203</u>
Covered OREO	-	-	152
Total covered nonperforming assets	<u>\$ 299</u>	<u>\$ 244</u>	<u>\$ 355</u>
<b>Total nonperforming</b>			
Nonaccrual loans	\$ 24,770	\$ 16,357	\$ 16,571
Accruing loans past due 90 days or more	284	144	37
TDRs <sup>(1)</sup>	598	720	821
Total nonperforming loans	<u>25,652</u>	<u>17,221</u>	<u>17,429</u>
OREO	2,181	3,969	3,962
Total nonperforming assets	<u>\$ 27,833</u>	<u>\$ 21,190</u>	<u>\$ 21,391</u>
<b>Additional Information</b>			
Performing TDRs <sup>(2)</sup>	\$ 10,822	\$ 5,855	\$ 5,676
Total Accruing TDRs <sup>(3)</sup>	11,420	6,575	6,497
<b>Non-covered ratios</b>			
Nonperforming loans to total loans	1.19%	0.81%	1.02%
Nonperforming assets to total assets	0.94%	0.75%	0.96%
Non-PCI allowance to nonperforming loans	93.71%	108.53%	107.63%
Non-PCI allowance to total loans	1.12%	0.88%	1.10%
<b>Total ratios</b>			
Nonperforming loans to total loans	1.20%	0.81%	1.02%
Nonperforming assets to total assets	0.94%	0.76%	0.97%
Allowance for loan losses to nonperforming loans	92.62%	106.99%	106.37%
Allowance for loan losses to total loans	1.11%	0.87%	1.09%

(1) TDRs restructured within the past six months and nonperforming TDRs exclude nonaccrual TDRs of \$1.88 million, \$95 thousand, and \$666 thousand for the periods ended June 30, 2020, December 31, 2019, and June 30, 2019, respectively.

(2) TDRs with six months or more of satisfactory payment performance exclude nonaccrual TDRs of \$413 thousand, \$2.25 million, and \$2.02 million for the periods ended June 30, 2020, December 31, 2019, and June 30, 2019, respectively.

- (3) Total accruing TDRs exclude nonaccrual TDRs of \$2.29 million, \$2.34 million, and \$2.73 million for the periods ended June 30, 2020, December 31, 2019, and June 30, 2019, respectively.

Non-covered nonperforming assets as of June 30, 2020, increased \$6.59 million, or 31.45%, from December 31, 2019, primarily due to an increase in non-covered nonaccrual loans acquired from Highlands Union Bank offset by a decrease in OREO of \$1.79 million. Non-covered nonaccrual loans as of June 30, 2020, increased \$8.36 million, or 51.87%, from December 31, 2019. As of June 30, 2020, non-covered nonaccrual loans were largely attributed to single family owner occupied (34.82%), non-farm, non-residential (26.79%), and single family non-owner occupied loans (12.55%). As of June 30, 2020, approximately \$7.18 million or 29.33%, of non-covered nonaccrual loans were attributed to performing loans acquired through the Highlands acquisition. 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, totaled \$35.86 million as of June 30, 2020, a slight increase of \$237 thousand, or 0.67%, compared to \$35.62 million as of December 31, 2019. Non-covered delinquent loans as a percent of total non-covered loans totaled 1.69% as of June 30, 2020, which includes past due loans (0.54%) and nonaccrual loans (1.15%).

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When restructuring loans for borrowers experiencing financial difficulty, we generally make concessions in interest rates, loan terms, 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 June 30, 2020, increased \$4.85 million, or 73.69%, to \$11.42 million from December 31, 2019. Unseasoned, or loans restructured within the last six months, and nonperforming accruing TDRs as of June 30, 2020, increased \$4.21 million to \$5.11 million compared to December 31, 2019. Unseasoned and nonperforming accruing TDRs as a percent of total accruing TDRs totaled 44.75% as of June 30, 2020, compared to 13.69% as of December 31, 2019. Specific reserves on TDRs totaled \$470 thousand as of June 30, 2020, compared to \$353 thousand as of December 31, 2019.

The Coronavirus Aid, Relief and Economic Security ("CARES") Act included provision allowing banks to not apply the guidance on accounting for troubled debt restructurings to loan modifications, such as extensions or deferrals, related to COVID-19 made between March 1, 2020 and the earlier of (i) December 31, 2020 or (ii) 60 days after the end of the COVID-19 national emergency. The relief can only be applied to modifications for borrowers that were not more than 30 days past due as of December 31, 2019. The Company elected to adopt this provision of the CARES Act.

Through June 30, 2020, we had modified 3,097 loans for \$436.11 million related to COVID-19 relief. Those modifications were generally short-term payment deferrals and are not considered TDR's based on the CARES Act. Our policy is to downgrade commercial loans modified for COVID-19 to special mention, which caused the significant increase in loans in that rating. Subsequent upgrade or downgrade will be on a case by case basis. The Company will consider upgrading these loans back to pass once the modification period has ended and timely contractual payments resume. Further downgrade would be based on a number of factors, including but not limited to additional modifications, payment performance and current underwriting.

The balance of non-accrual loans was higher at June 30, 2020, due mainly to the migration of three commercial real estate loans during the quarter with a total balance of \$2.63 million. The loans were past due prior to the COVID-19 emergency declaration and payments continued to slow during the quarter. Additionally, FCB suspended foreclosure and repossession activity at the end of March due to the COVID-19 pandemic and loans that would have normally been resolved through these processes remain in the portfolio at June 30, 2020.

Non-covered OREO, which is carried at the lesser of estimated net realizable value or cost, decreased \$1.79 million, or 45.05%, as of June 30, 2020, compared to December 31, 2019, and consisted of 19 properties with an average holding period of 12 months. The net loss on the sale of OREO totaled \$28 thousand for the three months ended June 30, 2020, compared to \$192 thousand for the same period of the prior year; the net loss on the sale of OREO for the six months ended June 30, 2020 totaled \$328 thousand compared to \$556 thousand for the same period of the prior year. The following table presents the changes in OREO during the periods indicated:

	<b>Six Months Ended June 30,</b>					
	<b>2020</b>			<b>2019</b>		
	<b>Non-covered</b>	<b>Covered</b>	<b>Total</b>	<b>Non-covered</b>	<b>Covered</b>	<b>Total</b>
<i>(Amounts in thousands)</i>						
Beginning balance	\$ 3,969	\$ -	\$ 3,969	\$ 3,806	\$ 32	\$ 3,838
Additions	621	-	621	2,564	130	2,694
Disposals	(2,005)	-	(2,005)	(2,129)	-	(2,129)
Valuation adjustments	(404)	-	(404)	(431)	(10)	(441)
Ending balance	<u>\$ 2,181</u>	<u>\$ -</u>	<u>\$ 2,181</u>	<u>\$ 3,810</u>	<u>\$ 152</u>	<u>\$ 3,962</u>

### *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. As of June 30, 2020, our allowance reflects a higher risk of loan losses due to uncertainty around the impact that the COVID-19 pandemic will have on business and economic conditions in our primary market areas. 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 June 30, 2020; however, no assurance can be made that additions to the allowance will not be required in future periods. For additional information, see 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 June 30, 2020, increased \$5.33 million, or 28.94%, from December 31, 2019 due primarily to the increased potential for loan defaults and losses related to the COVID-19 pandemic. The non-PCI allowance as a percent of non-covered loans totaled 1.12% as of June 30, 2020, compared to 0.88% as of December 31, 2019. Effective January 1, 2020, the Company collapsed the PCI loans and discounts for Peoples and Waccamaw acquired loans into the core loan portfolio. The Highlands transaction added the following pools: 1-4 Family, Senior-Consumer, 1-4 Family Senior-Commercial, 1-4 Family, Junior and Home Equity Lines, Commercial Land and Development, Farmland and Agricultural, Multi-family, Commercial Real Estate – Owner Occupied, Commercial Real Estate – Non-owner Occupied, Commercial and Industrial, and Consumer. Net charge-offs decreased \$78 thousand for the three months ended June 30, 2020, compared to the same period of the prior year. For the six months ended June 30, 2020, net charge-offs decreased \$534 thousand, compared with the same period of the prior year. The decrease in net charge-offs was driven by reduced losses in the single-family owner occupied loan pool.

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The following table presents the changes in the allowance for loan losses during the periods indicated:

	Three Months Ended June 30,					
	2020			2019		
	Non-PCI Portfolio	PCI Portfolio	Total	Non-PCI Portfolio	PCI Portfolio	Total
<i>(Amounts in thousands)</i>						
Beginning balance	\$ 21,137	\$ -	\$ 21,137	\$ 18,243	\$ -	\$ 18,243
Provision for (recovery of) loan losses charged to operations	3,831	-	3,831	1,585	-	1,585
Charge-offs	(1,672)	-	(1,672)	(2,114)	-	(2,114)
Recoveries	462	-	462	826	-	826
Net charge-offs	(1,210)	-	(1,210)	(1,288)	-	(1,288)
Ending balance	\$ 23,758	\$ -	\$ 23,758	\$ 18,540	\$ -	\$ 18,540

  

	Six Months Ended June 30,					
	2020			2019		
	Non-PCI Portfolio	PCI Portfolio	Total	Non-PCI Portfolio	PCI Portfolio	Total
<i>(Amounts in thousands)</i>						
Beginning balance	\$ 18,425	\$ -	\$ 18,425	\$ 18,267	\$ -	\$ 18,267
Provision for loan losses charged to operations	7,331	-	7,331	2,805	-	2,805
Charge-offs	(2,866)	-	(2,866)	(3,736)	-	(3,736)
Recoveries	868	-	868	1,204	-	1,204
Net charge-offs	(1,998)	-	(1,998)	(2,532)	-	(2,532)
Ending balance	\$ 23,758	\$ -	\$ 23,758	\$ 18,540	\$ -	\$ 18,540

*Deposits*

Total deposits as of June 30, 2020, increased \$167.93 million, or 7.21%, compared to December 31, 2019. The increase was largely attributable to noninterest-bearing demand deposits which increased \$125.03 million, or 19.91%. Interest-bearing demand and savings deposits also reflected growth with increases of \$66.95 million, or 13.46% and \$32.54 million, or 4.72%, respectively. These increases were offset by a decrease in time deposits of \$56.58 million, or 10.97%. We attribute a significant amount of the increase in deposits to the unprecedented level of federal government stimulus during the second quarter of 2020.

*Borrowings*

Total borrowings as of June 30, 2020, decreased \$500 thousand, compared to December 31, 2019.

**Liquidity and Capital Resources**

*Liquidity*

Liquidity is a measure of our ability to convert assets to cash or raise cash to meet financial obligations. We believe that liquidity management should encompass an overall balance sheet approach that draws together all sources and uses of liquidity. Poor or inadequate liquidity risk management may result in a funding deficit that could have a material impact on our operations. We maintain a liquidity risk management policy and contingency funding policy (“Liquidity Plan”) to detect potential liquidity issues and protect our 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”) of 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. The Liquidity Plan involves ongoing monitoring and estimation of potentially credit sensitive liabilities and the sources and amounts of balance sheet and external liquidity available to replace outflows during a funding crisis. The liquidity model incorporates various funding crisis scenarios and a specific action plan is formulated, and activated, when a financial shock that affects our normal funding activities is identified. Generally, the plan will reflect a strategy of replacing liability outflows with alternative liabilities, rather than balance sheet asset liquidity, to the extent that significant premiums can be avoided. If alternative liabilities are not available, outflows will be met through liquidation of balance sheet assets, including unpledged securities.

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As a financial holding company, the Company’s primary source of liquidity is dividends received from the Bank, which are subject to certain regulatory limitations. Other sources of liquidity include cash, investment securities, and borrowings. As of June 30, 2020, the Company’s cash reserves totaled \$8.87 million and availability on an unsecured, committed line of credit with an unrelated financial institution totaled \$15.00 million. The Company’s cash reserves and investments provide adequate working capital to meet obligations for the next twelve months.

In addition to cash on hand and deposits with other financial institutions, we rely on customer deposits, cash flows from loans and investment securities, and lines of credit from the FHLB and the Federal Reserve Bank (“FRB”) Discount Window to meet potential liquidity demands. These sources of liquidity are immediately available to satisfy deposit withdrawals, customer credit needs, and our operations. Secondary sources of liquidity include approved lines of credit with correspondent banks and unpledged available-for-sale securities. As of June 30, 2020, our unencumbered cash totaled \$421.49 million, unused borrowing capacity from the FHLB totaled \$365.67 million, available credit from the FRB Discount Window totaled \$6.08 million, available lines from correspondent banks totaled \$85.00 million, and unpledged available-for-sale securities totaled \$65.33 million.

*Cash Flows*

The following table summarizes the components of cash flow for the periods indicated:

	<b>Six Months Ended June 30,</b>	
	<b>2020</b>	<b>2019</b>
<i>(Amounts in thousands)</i>		
Net cash provided by operating activities	\$ 18,214	\$ 25,449
Net cash provided by investing activities	49,766	109,689
Net cash provided by (used in) financing activities	136,503	(55,533)
Net increase in cash and cash equivalents	204,483	79,605
Cash and cash equivalents, beginning balance	217,009	76,873
Cash and cash equivalents, ending balance	\$ 421,492	\$ 156,478

Cash and cash equivalents increased \$204.48 million for the six months ended June 30, 2020, compared to an increase of \$79.61 million for the same period of the prior year. The increase in cash and cash equivalents was driven by an increase in net cash provided in financing activities of \$192.04 million. The increase in net cash used in financing activities was driven by an increase in deposits of \$175.65 million; offset by the 2019 repayment of the wholesale repurchase agreement of \$25.00 million. Net cash provided by investing activities decreased \$59.92 million from the same period of the prior year. The decrease was primarily driven by a \$72.55 million net increase in loans.

*Capital Resources*

We are committed to effectively managing our capital to protect our depositors, creditors, and shareholders. Failure to meet certain capital requirements may result in actions by regulatory agencies that could have a material impact on our operations. Total stockholders’ equity as of June 30, 2020, decreased \$12.99 million, or 3.03%, to \$415.83 million from \$428.82 million as of December 31, 2019. The change in stockholders’ equity was largely due to net income of \$16.11 million offset by the repurchase of 734,653 shares of our common stock totaling \$21.87 million and dividends declared on our common stock of \$9.02 million. Accumulated other comprehensive loss decreased \$398 thousand to \$1.11 million as of June 30, 2020, compared to December 31, 2019, primarily due to net unrealized gains on securities. In accordance with current regulatory guidelines, accumulated other comprehensive income/(loss) is largely excluded from stockholders’ equity in the calculation of our capital ratios. Our book value per common share increased \$0.15 or 0.63% to \$23.48 as of June 30, 2020, from \$23.33 as of December 31, 2019.

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*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. Our current risk-based capital requirements are based on the international capital standards known as Basel III. A description of the Basel III capital rules is included in Part I, Item 1 of the 2019 Form 10-K. Our current required capital ratios are as follows:

- 4.5% Common Equity Tier 1 capital to risk-weighted assets (effectively 7.00% including the capital conservation buffer)
- 6.0% Tier 1 capital to risk-weighted assets (effectively 8.50% including the capital conservation buffer)
- 8.0% Total capital to risk-weighted assets (effectively 10.50% including the capital conservation buffer)
- 4.0% Tier 1 capital to average consolidated assets (“Tier 1 leverage ratio”)



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

	June 30, 2020		December 31, 2019	
	Company	Bank	Company	Bank
Common equity Tier 1 ratio	13.89%	13.23%	14.31%	12.87%
Tier 1 risk-based capital ratio	13.89%	13.23%	14.31%	12.87%
Total risk-based capital ratio	15.07%	14.41%	15.21%	13.78%
Tier 1 leverage ratio	10.18%	9.70%	14.01%	12.61%

Our risk-based capital ratios as of June 30, 2020, decreased from December 31, 2019, due to a decrease in total capital. The decrease in total capital was primarily attributable to the repurchase of 734,653 shares of our common stock totaling \$21.87 million, offset by net income of \$16.11 million. As of June 30, 2020, we continued to meet all capital adequacy requirements and were classified as well-capitalized under the regulatory framework for prompt corrective action. Management believes there have been no conditions or events since those notifications that would change the Bank's classification. Additionally, our capital ratios were in excess of the minimum standards under the Basel III capital rules as of June 30, 2020.

### 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:

	June 30, 2020	December 31, 2019
<i>(Amounts in thousands)</i>		
Commitments to extend credit	\$ 218,577	\$ 228,716
Standby letters of credit and financial guarantees <sup>(1)</sup>	174,545	167,612
Total off-balance sheet risk	<u>\$ 393,122</u>	<u>\$ 396,328</u>
Reserve for unfunded commitments	\$ 66	\$ 66

(1) Includes FHLB letters of credit

### Market Risk and Interest Rate Sensitivity

Market risk represents the risk of loss due to adverse changes in current and future cash flows, fair values, earnings, or capital due to movements in interest rates and other factors. Our profitability is largely dependent upon net interest income, which is subject to variation due to changes in the interest rate environment and unbalanced repricing opportunities. We are subject to interest rate risk when interest-earning assets and interest-bearing liabilities reprice at differing times, when underlying rates change at different levels or in varying degrees, when there is an unequal change in the spread between two or more rates for different maturities, and when embedded options, if any, are exercised. ALCO reviews 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. ALCO is also responsible for overseeing the formulation and implementation of policies and strategies to improve balance sheet positioning and mitigate the effect of interest rate changes.

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In order to manage our exposure to interest rate risk, we periodically review internal simulation and third-party models that project net interest income at risk, which measures the impact of different interest rate scenarios on net interest income, and the economic value of equity at risk, which measures potential long-term risk in the balance sheet by valuing our assets and liabilities at fair value under different interest rate scenarios. Simulation results show the existence and severity of interest rate risk in each scenario based on our current balance sheet position, assumptions about changes in the volume and mix of interest-earning assets and interest-bearing liabilities, and estimated yields earned on assets and rates paid on liabilities. The simulation model provides the best tool available to us and the industry for managing interest rate risk; however, the model cannot precisely predict the impact of fluctuations in interest rates on net interest income due to the use of significant estimates and assumptions. Actual results will differ from simulated results due to the timing, magnitude, and frequency of interest rate changes; changes in market conditions and customer behavior; and changes in our strategies that management might undertake in response to a sudden and sustained rate shock.

As of June 30, 2020, the Federal Open Market Committee had set the benchmark federal funds rate to a range of 0 to 25 basis points. Given the current level of benchmark interest rates, a complete downward shock of 100 basis points is rendered meaningless; accordingly, a downward rate scenario is only presented for the prior year end. In the downward rate shocks presented, benchmark interest rates were assumed at levels with floors near 0%. The following table presents the sensitivity of net interest income from immediate and sustained rate shocks in various interest rate scenarios over a twelve-month period for the periods indicated.

<u>Increase (Decrease) in Basis Points</u>	<u>Change in Net Interest Income</u>	<u>Percent Change</u>	<u>Change in Net Interest Income</u>	<u>Percent Change</u>
<i>(Dollars in thousands)</i>				
300	\$ 8,529	8.3%	\$ 171	0.2%
200	6,072	5.9%	428	0.4%
100	3,192	3.1%	426	0.4%
(100)	N/A	-	(4,631)	-4.3%

### ***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.

In anticipation of the potential discontinuance of the London Interbank Offered Rate (LIBOR) at the end of 2021, the Company has broken the transition efforts into two phases. The first phase is adding additional language to new loans that allows the Company to replace LIBOR with an equivalent rate index and adjust the margin to ensure the resulting interest rate is the same as it previously was using LIBOR. Also included in the first phase, the Company will be transitioning from the LIBOR swap curve to treasury rates when repricing certain loans. The second phase is transitioning current variable loans tied to LIBOR or on a LIBOR swap curve. The Company is currently quantifying the dollar amount and number of loans that extend beyond 2021.

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

The information required in this item is incorporated by reference to "Market Risk and Interest Rate Sensitivity" in Item 2 of this report.

### **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). Based upon that evaluation, the CEO and CFO concluded that, as of June 30, 2020, our disclosure controls and procedures were effective.

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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 about required disclosure.

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

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

We assess the adequacy of our internal control over financial reporting quarterly and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2020, 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

The risk factors set forth in our annual report on Form 10-K for the year ended December 31, 2019 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. If any of the risks occur and the market price of our common stock declines significantly, individuals may lose all, or part, of their investment in our Company. Individuals should carefully consider our risk factors and information included in our annual report on Form 10-K for the year ended December 31, 2019 before making an investment decision. There may be risks and uncertainties that we have not identified or that we have deemed immaterial that could adversely affect our business; therefore, such risk factors are not intended to be an exhaustive list of all risks we face. There have been no material changes to the risk factors included in Part I, Item 1A, “Risk Factors,” of our annual report on Form 10-K for the year ended December 31, 2019.

The Company is providing these additional risk factors to supplement the risk factors contained in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2019.

***The COVID-19 pandemic has adversely affected our business, financial condition and results of operations, and the ultimate impacts of the pandemic on our business, financial condition and results of operations will depend on future developments and other factors that are highly uncertain and will be impacted by the scope and duration of the pandemic and actions taken by governmental authorities in response to the pandemic.***

The ongoing COVID-19 global and national health emergency has caused significant disruption in the international and United States economies and financial markets and has had an adverse effect on our business, financial condition and results of operations. The spread of COVID-19 has caused illness, quarantines, cancellation of events and travel, business and school shutdowns, reduction in business activity and financial transactions, supply chain interruptions and overall economic and financial market instability. In response to the COVID-19 pandemic, the governments of the states in which we have branches and of most other states have taken preventative or protective actions, such as imposing restrictions on travel and business operations, advising or requiring individuals to limit or forego their time outside of their homes, and ordering temporary closures of businesses that have been deemed to be non-essential. These restrictions and other consequences of the pandemic have resulted in significant adverse effects for many different types of businesses, including, among others, those in the travel, hospitality and food and beverage industries, and have resulted in a significant number of layoffs and furloughs of employees nationwide and in the regions in which we operate.

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The ultimate effects of the COVID-19 pandemic on the broader economy and the markets that we serve are not known nor is the ultimate length of the restrictions described above and any accompanying effects. Moreover, the Federal Reserve has taken action to lower the Federal Funds rate, which may negatively affect our interest income and, therefore, earnings, financial condition and results of operation. This may include, or exacerbate, among other consequences, the following:

- employees contracting COVID-19;
- reductions in our operating effectiveness as our employees work from home;
- increased cybersecurity risk due to the continuation of the work-from-home measures;
- a work stoppage, forced quarantine, or other interruption of our business;
- unavailability of key personnel necessary to conduct our business activities;
- effects on key employees, including operational management personnel and those charged with preparing, monitoring and evaluating our financial reporting and internal controls;
- sustained closures of our branch lobbies or the offices of our customers;
- declines in demand for loans and other banking services and products;
- reduced consumer spending due to both job losses and other effects attributable to the COVID-19 pandemic;
- unprecedented volatility in United States financial markets;
- volatile performance of our investment securities portfolio;
- decline in the credit quality of our loan portfolio, owing to the effects of the COVID-19 pandemic in the markets we serve, leading to a need to increase our allowance for loan losses;
- declines in value of collateral for loans, including real estate collateral;
- declines in the net worth and liquidity of borrowers and loan guarantors, impairing their ability to honor commitments to us; and
- declines in demand resulting from businesses being deemed to be “non-essential” by governments in the markets we serve, and from “non-essential” and “essential” businesses suffering adverse effects from reduced levels of economic activity in our markets.

These factors, together or in combination with other events or occurrences that may not yet be known or anticipated, may materially and adversely affect our business, financial condition and results of operations.

The ongoing COVID-19 pandemic has resulted in meaningfully lower stock prices for many companies, as well as the trading prices for many other securities. The further spread of the COVID-19 outbreak, as well as ongoing or new governmental, regulatory and private sector responses to the pandemic, may materially disrupt banking and other economic activity generally and in the areas in which we operate. This could result in further decline in demand for our banking products and services, and could negatively impact, among other things, our liquidity, regulatory capital and our growth strategy. Any one or more of these developments could have a material adverse effect on our business, financial condition and results of operations.

We are taking precautions to protect the safety and well-being of our employees and customers. However, no assurance can be given that the steps being taken will be adequate or deemed to be appropriate, nor can we predict the level of disruption which will occur to our employee's ability to provide customer support and service. If we are unable to recover from a business disruption on a timely basis, our business, financial condition and results of operations could be materially and adversely affected. We may also incur additional costs to remedy damages caused by such disruptions, which could further adversely affect our business, financial condition and results of operations.

*As a participating lender in the SBA Paycheck Protection Program ("PPP"), the Company and the Bank are subject to additional risks of litigation from the Bank's customers or other parties regarding the Bank's processing of loans for the PPP and risks that the SBA may not fund some or all PPP loan guaranties.*

On March 27, 2020, President Trump signed the CARES Act, which included a \$349 billion loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Bank is participating as a lender in the PPP. The PPP opened on April 3, 2020 and on or about April 16, 2020, the SBA notified lenders that the \$349 billion earmarked for the PPP was exhausted. Congress approved additional funding for the PPP of approximately \$320 billion on April 24, 2020. As of June 30, 2020, we have funded approximately 758 loans with original principal balances totaling \$60.23 million through the PPP program.

Since the opening of the PPP, several other larger banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP. The Company and the Bank may be exposed to the risk of litigation, from both customers and non-customers who approached the Bank regarding PPP loans, regarding its process and procedures used in processing applications for the PPP. If any such litigation is filed against the Company or the Bank and is not resolved in a manner favorable to the Company or the Bank, it may result in significant financial liability or adversely affect the Company's reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP related litigation could have a material adverse impact on our business, financial condition and results of operations.

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The Bank also has credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced by the Bank, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the PPP. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by the Company, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from the Company.

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

- (a) Not Applicable
- (b) Not Applicable
- (c) Issuer Purchases of Equity Securities

We repurchased no shares of our common stock during the second quarter of 2020 compared to 194,000 shares during the same quarter of 2019. We do not currently have a publicly announced plan to repurchase shares.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

None.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

- 2.1 [Agreement and Plan of Reincorporation and Merger between First Community Bancshares, Inc. and First Community Bankshares, Inc., incorporated by reference to Appendix A of the Definitive Proxy Statement on Form DEF 14A dated April 24, 2018, filed on March 13, 2018](#)
- 2.2 [Agreement and Plan of Merger between First Community Bankshares, Inc. and Highlands Bankshares, Inc., incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K dated and filed September 11, 2019](#)
- 3.1 [Articles of Incorporation of First Community Bankshares, Inc., incorporated by reference to Appendix B of the Definitive Proxy Statement on Form DEF 14A dated April 24, 2018, filed on March 13, 2018](#)
- 3.2 [Bylaws of First Community Bankshares, Inc., incorporated by reference to Exhibit 3.2 of the Current Report on Form 8-K dated and filed October 2, 2018](#)
- 4.1 [Description of First Community Bankshares, Inc. Common Stock, incorporated by reference to Exhibit 4.1 of the Current Report on](#)

- Form 8-K dated and filed October 2, 2018
- 4.2 [Form of First Community Bankshares, Inc. Common Stock Certificate, incorporated by reference to Exhibit 4.2 of the Current Report on Form 8-K dated and filed October 2, 2018](#)
- 10.1.1\*\* [First Community Bancshares, Inc. 1999 Stock Option Plan, incorporated by reference to Exhibit 10.1 of the Annual Report on Form 10-K/A for the period ended December 31, 1999, filed on April 13, 2000](#)
- 10.1.2\*\* [Amendment One to the First Community Bancshares, Inc. 1999 Stock Option Plan, incorporated by reference to Exhibit 10.1.1 of the Quarterly Report on Form 10-Q for the period ended March 31, 2004, filed on May 7, 2004](#)
- 10.2\*\* [First Community Bancshares, Inc. 1999 Stock Option Agreement, incorporated by reference to Exhibit 10.5 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 13, 2002](#)
- 10.3\*\* [First Community Bancshares, Inc. 2001 Nonqualified Director Stock Option Agreement, incorporated by reference to Exhibit 10.4 of the Quarterly Report on Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002](#)
- 10.4\*\* [First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan, incorporated by reference to Annex B of the Definitive Proxy Statement on Form DEF 14A dated April 27, 2004, filed on March 15, 2004](#)

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- 10.5\*\* [First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan Stock Award Agreement, incorporated by reference to Exhibit 10.13 of the Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed on August 6, 2004](#)
- 10.6\*\* [First Community Bancshares, Inc. 2012 Omnibus Equity Compensation Plan, incorporated by reference to Appendix B of the Definitive Proxy Statement on Form DEF 14A dated April 24, 2012, filed on March 7, 2012](#)
- 10.7\*\* [First Community Bancshares, Inc. 2012 Omnibus Equity Compensation Plan Restricted Stock Grant Agreement, incorporated by reference to Exhibit 99.1 of the Current Report on Form 8-K dated and filed May 28, 2013](#)
- 10.8\*\* [First Community Bancshares, Inc. Life Insurance Endorsement Method Split Dollar Plan and Agreement, incorporated by reference to Exhibit 10.5 of the Annual Report on Form 10-K/A for the period ended December 31, 1999, filed on April 13, 2000](#)
- 10.9.1\*\* [First Community Bancshares, Inc. and Affiliates Executive Retention Plan, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated December 30, 2008, filed on January 5, 2009;](#)
- 10.9.2\*\* [Amendment #1 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan, incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010](#)
- 10.9.3\*\* [Amendment #2 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated February 21, 2013, filed on February 25, 2013](#)
- 10.9.4\*\* [Amendment #3 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated May 24, 2016, filed on May 31, 2016](#)
- 10.9.5\*\* [Amendment #4 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated and filed on February 28, 2017](#)
- 10.10\*\* [Amended and Restated Deferred Compensation Plan for Directors of First Community Bancshares, Inc. and Affiliates, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated December 16, 2019, filed on December 19, 2019](#)
- 10.11.1\*\* [First Community Bancshares, Inc. Amended and Restated Nonqualified Supplemental Cash or Deferred Retirement Plan, incorporated by reference to Exhibit 99.1 of the Current Report on Form 8-K dated August 22, 2006, filed on August 23, 2006, and Amendment #2, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K dated and filed on February 28, 2017](#)
- 10.11.2\*\* [Amendment #2 to the First Community Bancshares, Inc. Amended and Restated Nonqualified Supplemental Cash or Deferred Retirement Plan, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K dated and filed on February 28, 2017](#)
- 10.12.1\*\* [First Community Bancshares, Inc. Supplemental Directors Retirement Plan, as amended and restated, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated December 16, 2010, filed on December 17, 2010, and Amendment #2, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K dated May 24, 2016, filed on May 31, 2016](#)
- 10.12.2\*\* [Amendment #2 to the First Community Bancshares, Inc. Supplemental Directors Retirement Plan, as amended and restated, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K dated May 24, 2016, filed on May 31, 2016](#)
- 10.13\*\* [Employment Agreement between First Community Bancshares, Inc. and David D. Brown, incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K dated and filed on April 16, 2015](#)
- 10.14\*\* [Employment Agreement between First Community Bancshares, Inc. and E. Stephen Lilly, incorporated by reference to Exhibit 10.5 of the Current Report on Form 8-K dated and filed on April 16, 2015](#)
- 10.15\*\* [Employment Agreement between First Community Bancshares, Inc. and Gary R. Mills, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K dated and filed on April 16, 2015](#)
- 10.16\*\* [Employment Agreement between First Community Bancshares, Inc. and William P. Stafford, II, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated and filed on April 16, 2015](#)
- 10.17\*\* [Employment Agreement between First Community Bank and Mark R. Evans, incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K dated April 2, 2009, filed on April 3, 2009](#)
- 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 formatted in Inline Extensible Business Reporting Language (iXBRL): (i) Condensed Consolidated Balance Sheets as of June 30, 2020, (Unaudited) and December 31, 2019; (ii) Condensed Consolidated Statements of Income (Unaudited) for the three and six months ended June 30, 2020 and 2019; (iii) Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the three and six months ended June 30, 2020 and 2019; (iv) Condensed Consolidated Statements of Stockholders' Equity (Unaudited) for the three and six months ended June 30, 2020 and 2019; (v) Condensed Consolidated Statements of Cash Flows (Unaudited) for the six months ended June 30, 2020 and 2019; and (vi) Notes to Condensed Consolidated Financial Statements (Unaudited).
- 104\* The cover page of First Community Bankshares, Inc. Quarterly Report on Form 10-Q for the quarter ended June 30, 2020, formatted in Inline XBRL (included within the Exhibit 101 attachments).

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- \* Filed herewith
- \*\* Indicates a management contract or compensation plan or agreement. These contracts, plans, or agreements were assumed by First Community Bankshares, Inc. in October 2018 in connection with First Community Bancshares, Inc., a Nevada corporation, merging with and into its wholly-owned subsidiary, First Community Bankshares, Inc., a Virginia corporation, pursuant to an Agreement and Plan of Reincorporation and Merger with First Community Bankshares, Inc. continuing as the surviving corporation.
- \*\*\* Submitted electronically herewith

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 10<sup>th</sup> day of August, 2020.

First Community Bankshares, 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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## **Section 2: EX-31.1 (EXHIBIT 31.1)**

**Exhibit 31.1**

### **CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER**

I, William P. Stafford, II, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Community Bankshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2020

/s/ William P. Stafford, II  
William P. Stafford, II  
Chief Executive Officer

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## Section 3: EX-31.2 (EXHIBIT 31.2)

**Exhibit 31.2**

### CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, David D. Brown, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Community Bankshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2020

/s/ David D. Brown

David D. Brown  
Chief Financial Officer

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## Section 4: EX-32 (EXHIBIT 32)

Exhibit 32

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned certify, to their best knowledge and belief, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Quarterly Report on Form 10-Q of First Community Bankshares, Inc. (the "Company") for the period ended June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2020

By: /s/ William P. Stafford, II

William P. Stafford, II  
Chief Executive Officer

By: /s/ David D. Brown

David D. Brown  
Chief Financial Officer

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