

Community Bankers Trust Corp  
Form 10-Q  
November 09, 2010  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from            to

Commission File Number: 001-32590

**COMMUNITY BANKERS TRUST CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: Community Bankers Trust Corp - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
**4235 Innslake Drive, Suite 200**  
**Glen Allen, Virginia**  
(Address of principal executive offices)

**20-2652949**  
(I.R.S. Employer  
Identification No.)  
**23060**  
(Zip Code)

**(804) 934-9999**  
(Registrant's telephone number, including area code)

n/a

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At September 30, 2010, there were 21,468,455 shares of the Company's common stock outstanding.

**Table of Contents**

**COMMUNITY BANKERS TRUST CORPORATION**

TABLE OF CONTENTS

FORM 10-Q

September 30, 2010

PART I FINANCIAL INFORMATION

|  |    |
|--|----|
| Item 1. Financial Statements   |    |
| <u>Consolidated Statements of Financial Condition (Unaudited)</u>                                    | 3  |
| <u>Consolidated Statements of Operations (Unaudited)</u>   | 4  |
| <u>Consolidated Statements of Stockholders' Equity (Unaudited)</u>                                   | 5  |
| <u>Consolidated Statements of Cash Flows (Unaudited)</u>   | 6  |
| <u>Notes to Unaudited Consolidated Financial Statements</u>  | 8  |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 29 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | 46 |
| Item 4. <u>Controls and Procedures</u>   | 47 |
| PART II OTHER INFORMATION  |    |
| Item 1. <u>Legal Proceedings</u>   | 50 |
| Item 1A. <u>Risk Factors</u>   | 50 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 51 |
| Item 3. <u>Defaults upon Senior Securities</u>   | 51 |
| Item 4. <u>(Removed and Reserved)</u>  | 51 |
| Item 5. <u>Other Information</u>   | 51 |
| Item 6. <u>Exhibits</u>  | 51 |
| <u>SIGNATURES</u>  | 52 |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****COMMUNITY BANKERS TRUST CORPORATION****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****AS OF SEPTEMBER 30, 2010 AND DECEMBER 31, 2009**

|  | September 30, 2010<br>(Unaudited) | December 31, 2009<br>(Audited) |
|--|-----------------------------------|--------------------------------|
|  | (dollars in thousands)            |                                |
| <b>ASSETS</b>  |                                   |                                |
| Cash and due from banks  | \$ 12,418                         | \$ 13,575                      |
| Interest bearing bank deposits   | 12,504                            | 18,660                         |
| Federal funds sold   | 2,942                             |                                |
| Total cash and cash equivalents  | 27,864                            | 32,235                         |
| Securities available for sale, at fair value   | 237,088                           | 179,440                        |
| Securities held to maturity, at cost (fair value of \$96,540 and \$117,008, respectively)  | 91,765                            | 113,165                        |
| Equity securities, restricted, at cost   | 6,990                             | 8,346                          |
| Total securities   | 335,843                           | 300,951                        |
| Loans not covered by FDIC shared loss agreement  | 547,509                           | 578,629                        |
| Loans covered by FDIC shared loss agreement  | 123,172                           | 150,935                        |
| Total loans  | 670,681                           | 729,564                        |
| Allowance for loan losses (non-covered loans of \$34,353 and \$18,169, respectively; covered loans of \$829 and \$0, respectively) | (35,182)                          | (18,169)                       |
| Net loans  | 635,499                           | 711,395                        |
| FDIC indemnification asset   | 61,170                            | 76,107                         |
| Bank premises and equipment, net   | 35,985                            | 37,105                         |
| Other real estate owned, covered by FDIC shared loss agreement   | 10,104                            | 12,822                         |
| Other real estate owned, non-covered   | 4,320                             | 1,586                          |
| Bank owned life insurance  | 6,759                             | 6,534                          |
| FDIC receivable under shared loss agreement  | 24,269                            | 7,950                          |
| Core deposit intangibles, net  | 15,384                            | 17,080                         |
| Goodwill   |                                   | 5,727                          |
| Other assets   | 20,645                            | 17,231                         |
| Total assets   | \$ 1,177,842                      | \$ 1,226,723                   |
| <b>LIABILITIES</b>   |                                   |                                |
| Deposits:  |                                   |                                |
| Noninterest bearing  | \$ 69,494                         | \$ 62,198                      |
| Interest bearing   | 948,251                           | 969,204                        |

Edgar Filing: Community Bankers Trust Corp - Form 10-Q

|                                 |                  |                  |
|---------------------------------|------------------|------------------|
| Total deposits                  | 1,017,745        | 1,031,402        |
| Federal funds purchased         |                  | 8,999            |
| Federal Home Loan Bank advances | 37,000           | 37,000           |
| Trust preferred capital notes   | 4,124            | 4,124            |
| Other liabilities               | 8,241            | 13,604           |
| <b>Total liabilities</b>        | <b>1,067,110</b> | <b>1,095,129</b> |

**STOCKHOLDERS EQUITY**

|  |                     |                     |
|--|---------------------|---------------------|
| Preferred stock (5,000,000 shares authorized, \$0.01 par value; 17,680 shares issued and outstanding)    | 17,680              | 17,680              |
| Warrants on preferred stock  | 1,037               | 1,037               |
| Discount on preferred stock  | (709)               | (854)               |
| Common stock (200,000,000 shares authorized, \$0.01 par value; 21,468,455 shares issued and outstanding) | 215                 | 215                 |
| Additional paid in capital   | 143,999             | 143,999             |
| Retained deficit   | (57,144)            | (32,019)            |
| Accumulated other comprehensive income   | 5,654               | 1,536               |
| <b>Total stockholders equity</b>   | <b>110,732</b>      | <b>131,594</b>      |
| <b>Total liabilities and stockholders equity</b>   | <b>\$ 1,177,842</b> | <b>\$ 1,226,723</b> |

See accompanying notes to unaudited consolidated financial statements

**Table of Contents**

**COMMUNITY BANKERS TRUST CORPORATION**  
**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (RESTATED)**  
**(dollars and shares in thousands, except per share data)**

|  | For the three months ended |                       | For the nine months ended |                       |
|--|----------------------------|-----------------------|---------------------------|-----------------------|
|  | September 30,<br>2010      | September 30,<br>2009 | September 30,<br>2010     | September 30,<br>2009 |
| <b>Interest and dividend income</b>                        |                            |                       |                           |                       |
| Interest and fees on non-covered loans                     | \$ 8,235                   | \$ 8,820              | \$ 25,436                 | \$ 26,236             |
| Interest and fees on FDIC covered loans                    | 3,692                      | 4,152                 | 10,671                    | 11,380                |
| Interest on federal funds sold                             | 1                          | 10                    | 5                         | 36                    |
| Interest on deposits in other banks                        | 19                         | 60                    | 73                        | 262                   |
| Interest and dividends on securities                       |                            |                       |                           |                       |
| Taxable  | 2,340                      | 2,081                 | 6,507                     | 7,580                 |
| Nontaxable   | 866                        | 896                   | 2,640                     | 2,473                 |
| <b>Total interest and dividend income</b>                  | <b>15,153</b>              | <b>16,019</b>         | <b>45,332</b>             | <b>47,967</b>         |
| <b>Interest expense</b>                                    |                            |                       |                           |                       |
| Interest on deposits                                       | 4,141                      | 6,026                 | 13,485                    | 18,443                |
| Interest on federal funds purchased                        | 1                          | 2                     | 1                         | 6                     |
| Interest on other borrowed funds                           | 342                        | 338                   | 1,006                     | 1,071                 |
| <b>Total interest expense</b>                              | <b>4,484</b>               | <b>6,366</b>          | <b>14,492</b>             | <b>19,520</b>         |
| <b>Net interest income</b>                                 | <b>10,669</b>              | <b>9,653</b>          | <b>30,840</b>             | <b>28,447</b>         |
| <b>Provision for loan losses</b>                           | <b>1,116</b>               | <b>5,231</b>          | <b>27,440</b>             | <b>11,271</b>         |
| <b>Net interest income after provision for loan losses</b> | <b>9,553</b>               | <b>4,422</b>          | <b>3,400</b>              | <b>17,176</b>         |
| <b>Noninterest income</b>                                  |                            |                       |                           |                       |
| Service charges on deposit accounts                        | 659                        | 674                   | 1,846                     | 1,863                 |
| Gain on bank acquisition transaction                       |                            |                       |                           | 20,255                |
| Gain (loss) on securities transactions, net                | (296)                      | 612                   | (394)                     | 905                   |
| Gain (loss) on sale of other real estate, net              | (770)                      | 500                   | (4,329)                   | 563                   |
| Other  | (1,120)                    | 356                   | 1,650                     | 1,337                 |
| <b>Total noninterest income</b>                            | <b>(1,527)</b>             | <b>2,142</b>          | <b>(1,227)</b>            | <b>24,923</b>         |
| <b>Noninterest expense</b>                                 |                            |                       |                           |                       |
| Salaries and employee benefits                             | 5,255                      | 4,840                 | 15,191                    | 14,294                |
| Occupancy expenses   | 774                        | 752                   | 2,226                     | 1,886                 |
| Equipment expenses   | 322                        | 436                   | 1,097                     | 1,198                 |
| Legal fees   | 117                        | 217                   | 259                       | 772                   |
| Professional fees  | 425                        | 185                   | 1,502                     | 1,341                 |
| FDIC assessment  | 579                        | 436                   | 1,797                     | 1,310                 |
| Data processing fees                                       | 735                        | 743                   | 1,813                     | 2,217                 |
| Amortization of intangibles                                | 565                        | 565                   | 1,696                     | 1,675                 |

Edgar Filing: Community Bankers Trust Corp - Form 10-Q

|   |            |            |             |             |
|---|------------|------------|-------------|-------------|
| Impairment of goodwill                        |            |            | 5,727       | 24,032      |
| Other operating expenses                      | 1,615      | 1,765      | 5,114       | 5,118       |
| Total noninterest expense                     | 10,387     | 9,939      | 36,422      | 53,843      |
| Loss before income taxes                      | (2,361)    | (3,375)    | (34,249)    | (11,744)    |
| Income tax (benefit) expense                  | (1,062)    | (1,473)    | (10,570)    | 3,380       |
| Net loss                                      | \$ (1,299) | \$ (1,902) | \$ (23,679) | \$ (15,124) |
| Dividends accrued on preferred stock          |            | 223        | 442         | 661         |
| Accretion of discount on preferred stock      | 48         | 47         | 145         | 135         |
| Accumulated preferred dividends               | 221        |            | 221         |             |
| Net loss available to common stockholders     | \$ (1,568) | \$ (2,172) | \$ (24,487) | \$ (15,920) |
| Net loss per share basic                      | \$ (0.07)  | \$ (0.10)  | \$ (1.14)   | \$ (0.74)   |
| Net loss per share diluted                    | \$ (0.07)  | \$ (0.10)  | \$ (1.14)   | \$ (0.74)   |
| Weighted average number of shares outstanding |            |            |             |             |
| basic   | 21,468     | 21,468     | 21,468      | 21,468      |
| diluted                                       | 21,468     | 21,468     | 21,468      | 21,468      |

See accompanying notes to unaudited consolidated financial statements

**Table of Contents**

**COMMUNITY BANKERS TRUST CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND**  
**THE YEAR ENDED DECEMBER 31, 2009**

(dollars and shares in thousands)

|  | Preferred<br>Stock | Warrants | Discount<br>on Preferred<br>Stock | Common Stock<br>Shares | Common Stock<br>Amount | Additional<br>Paid in<br>Capital | Retained<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income | Total      |
|--|--------------------|----------|-----------------------------------|------------------------|------------------------|----------------------------------|---------------------|---|------------|
| <b>Balance January 1, 2009</b>   | \$ 17,680          | \$ 1,037 | \$ (1,031)                        | 21,468                 | \$ 215                 | \$ 146,076                       | \$ 1,691            | \$ (1,265)                                      | \$ 164,403 |
| Amortization of preferred stock warrants   |                    |          | 177                               |                        |                        |                                  | (177)               |   |            |
| Reclassification for preferred stock dividends                                     |                    |          |                                   |                        |                        |                                  | 37                  |   | 37         |
| Repurchase of warrants   |                    |          |                                   |                        |                        | (2,077)                          |                     |   | (2,077)    |
| Dividends paid on preferred stock  |                    |          |                                   |                        |                        |                                  | (800)               |   | (800)      |
| Comprehensive income:  |                    |          |                                   |                        |                        |                                  |                     |   |            |
| Net loss   |                    |          |                                   |                        |                        |                                  | (29,335)            |   | (29,335)   |
| Change in unrealized gain/loss in investment securities, net of tax of \$1,576     |                    |          |                                   |                        |                        |                                  |                     | 3,059   | 3,059      |
| Less: Reclassification adjustment for gain on securities sold, net of tax of \$291 |                    |          |                                   |                        |                        |                                  |                     | (565)   | (565)      |
| Change in funded status of pension plan, net of tax of \$158                       |                    |          |                                   |                        |                        |                                  |                     | 307   | 307        |
| Total comprehensive loss   |                    |          |                                   |                        |                        |                                  |                     |   | (26,534)   |
| Dividends paid on common stock (\$ .16 per share)                                  |                    |          |                                   |                        |                        |                                  | (3,435)             |   | (3,435)    |
| <b>Balance December 31, 2009 (Audited)</b>   | \$ 17,680          | \$ 1,037 | \$ (854)                          | 21,468                 | \$ 215                 | \$ 143,999                       | \$ (32,019)         | \$ 1,536  | \$ 131,594 |
| Amortization of preferred stock warrants   |                    |          | 145                               |                        |                        |                                  | (145)               |   |            |
| Dividends paid on preferred stock  |                    |          |                                   |                        |                        |                                  | (442)               |   | (442)      |
| Comprehensive income:  |                    |          |                                   |                        |                        |                                  |                     |   |            |
| Net loss   |                    |          |                                   |                        |                        |                                  | (23,679)            |   | (23,679)   |
| Change in funded status of pension plan, net of tax of \$283                       |                    |          |                                   |                        |                        |                                  |                     | (550)   | (550)      |
| Change in unrealized gain/loss in equity securities                                |                    |          |                                   |                        |                        |                                  |                     | (6)   | (6)        |
| Change in unrealized gain/loss in investment securities, net of tax of \$2,174     |                    |          |                                   |                        |                        |                                  |                     | 4,414   | 4,414      |
| Less: Reclassification adjustment for gain on securities sold, net of tax of       |                    |          |                                   |                        |                        |                                  |                     | (43)  | (43)       |



Edgar Filing: Community Bankers Trust Corp - Form 10-Q

|  |           |          |          |        |        |            |             |          |  |                 |
|--|-----------|----------|----------|--------|--------|------------|-------------|----------|--|-----------------|
| \$22   |           |          |          |        |        |            |             |          |  |                 |
| Less: Reclassification adjustment for loss on securities available for sale related to other than temporary impairments, net of tax of \$156 |           |          |          |        |        |            |             | 303      |  | 303             |
| <b>Total comprehensive loss</b>  |           |          |          |        |        |            |             |          |  | <b>(19,561)</b> |
| Dividends paid on common stock (\$0.04 per share)  |           |          |          |        |        |            |             | (859)    |  | (859)           |
| <b>Balance September 30, 2010 (Unaudited)</b>  | \$ 17,680 | \$ 1,037 | \$ (709) | 21,468 | \$ 215 | \$ 143,999 | \$ (57,144) | \$ 5,654 |  | \$ 110,732      |

See accompanying notes to unaudited consolidated financial statements

**Table of Contents**

**COMMUNITY BANKERS TRUST CORPORATION**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (RESTATED)**

(dollars in thousands)

|   | September 30,<br>2010 | September 30,<br>2009 |
|---|-----------------------|-----------------------|
| <b>Operating activities:</b>  |                       |                       |
| Net loss  | \$ (23,679)           | \$ (15,124)           |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                       |                       |
| Depreciation and intangibles amortization   | 3,245                 | 3,130                 |
| Provision for loan losses   | 27,440                | 11,271                |
| Amortization of security premiums and accretion of discounts, net                         | 1,246                 | 1,411                 |
| Change in loans held for sale   |                       | 200                   |
| Net gain on bank acquisition transaction  |                       | (20,255)              |
| Impairment of goodwill  | 5,727                 | 24,032                |
| Net loss (gain) on sale of securities   | 394                   | (905)                 |
| Net loss (gain) on sale and valuation of other real estate                                | 4,329                 | (563)                 |
| Net loss on sale of loans   |                       | 13                    |
| Changes in assets and liabilities:  |                       |                       |
| (Increase) decrease in other assets   | (5,804)               | 124                   |
| Decrease in accrued expenses and other liabilities  | (7,859)               | (5,017)               |
| Net cash provided by (used in) operating activities                                       | 5,039                 | (1,683)               |
| <b>Investing activities:</b>  |                       |                       |
| Proceeds from securities sales, calls, maturities, and paydowns                           | 61,248                | 147,928               |
| Purchase of securities  | (90,383)              | (143,244)             |
| Proceeds from sale of other real estate   | 5,007                 |                       |
| Cash acquired in bank acquisition transaction   |                       | 54,717                |
| Net decrease (increase) in loans, excluding covered loans                                 | 16,647                | (49,105)              |
| Net decrease in loans, covered by FDIC shared loss agreement                              | 21,466                | 32,168                |
| Principal recoveries of loans previously charged off                                      | 991                   |                       |
| Purchase of premises and equipment, net   | (429)                 | (14,634)              |
| Net cash provided by investing activities   | 14,547                | 27,830                |
| <b>Financing activities:</b>  |                       |                       |
| Net decrease in noninterest bearing and interest bearing demand deposits                  | (13,657)              | (81,575)              |
| Net (decrease) increase in federal funds purchased  | (8,999)               | 31                    |
| Cash paid to reduce FHLB borrowings   |                       | (38,425)              |
| Cash paid to redeem shares related to asserted appraisal rights and retire warrants       |                       | (2,077)               |
| Cash dividends paid   | (1,301)               | (3,236)               |
| Net cash used in financing activities   | (23,957)              | (125,282)             |
| <b>Net decrease in cash and cash equivalents</b>  | <b>(4,371)</b>        | <b>(99,135)</b>       |

Edgar Filing: Community Bankers Trust Corp - Form 10-Q

**Cash and cash equivalents:**

|                         |    |        |    |         |
|-------------------------|----|--------|----|---------|
| Beginning of the period | \$ | 32,235 | \$ | 128,433 |
| End of the period       | \$ | 27,864 | \$ | 29,298  |

Continued

**Table of Contents**

|   | September 30,<br>2010 | September 30,<br>2009 |
|---|-----------------------|-----------------------|
| <b>Supplemental disclosures of cash flow information:</b> |                       |                       |
| Interest paid   | \$ 15,307             | \$ 20,686             |
| Income taxes paid   | 250                   | 296                   |
| Transfers of OREO property                                | 9,352                 | 952                   |
| Transactions related to acquisition                       |                       |                       |
| Increase in assets and liabilities:                       |                       |                       |
| Loans, net  | \$                    | \$ 198,253            |
| Other real estate owned                                   |                       | 9,416                 |
| Securities  |                       | 4,954                 |
| FDIC indemnification                                      |                       | 84,584                |
| Fixed assets, net   |                       | 37                    |
| Other assets  |                       | 10,332                |
| Deposits  |                       | 302,756               |
| Borrowings  |                       | 37,525                |
| Other liabilities   |                       | 1,757                 |

See accompanying notes to unaudited consolidated financial statements

---

**Table of Contents**

**1. Nature of Banking Activities and Significant Accounting Policies**

**Organization**

Community Bankers Trust Corporation (the Company) is a bank holding company that was incorporated under Delaware law on April 6, 2005. The Company is headquartered in Glen Allen, Virginia and is the holding company for Essex Bank (the Bank), a Virginia state bank with 25 full-service offices in Virginia, Maryland and Georgia.

The Company was initially formed as a special purpose acquisition company to effect a merger, capital stock exchange, asset acquisition or other similar business combination with an operating business in the banking industry. Prior to its acquisition of two bank holding companies in 2008, the Company's activities were limited to organizational matters, completing its initial public offering and seeking and evaluating possible business combination opportunities. On May 31, 2008, the Company acquired each of TransCommunity Financial Corporation, a Virginia corporation (TFC), and BOE Financial Services of Virginia, Inc., a Virginia corporation (BOE). The Company changed its corporate name in connection with the acquisitions. On November 21, 2008, the Bank acquired certain assets and assumed all deposit liabilities relating to four former branch offices of The Community Bank (TCB) in Georgia. On January 30, 2009, the Bank acquired substantially all assets and assumed all deposit and certain other liabilities relating to seven former branch offices of Suburban Federal Savings Bank (SFSB) in Maryland.

The Bank was established in 1926 and is headquartered in Tappahannock, Virginia. The Bank engages in general commercial banking business and provides a wide range of financial services primarily to individuals and small businesses, including individual and commercial demand and time deposit accounts, commercial and consumer loans, travelers checks, safe deposit box facilities, investment services and fixed rate residential mortgages. Fourteen branches are located in Virginia, primarily from the Chesapeake Bay to just west of Richmond, seven are located in Maryland along the Baltimore-Washington corridor and four are located in the Atlanta, Georgia metropolitan market.

**Financial Statements**

The consolidated statements presented include accounts of the Company and the Bank, its wholly-owned subsidiary. All material intercompany balances and transactions have been eliminated. The statements should be read in conjunction with the Company's consolidated financial statements and the accompanying notes to consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. In the opinion of management, all adjustments, consisting of normal accruals, were made that are necessary to present fairly the financial position of the Company at September 30, 2010, and the results of its operations, changes in stockholders' equity, and its cash flows for the three and nine months ended September 30, 2010.

The accounting and reporting policies of the Company conform to GAAP and to the general practices within the banking industry. The interim financial statements have not been audited; however, in the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the consolidated financial statements have been included. Operating results for the three and nine month periods ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010.

The financial information contained within the statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. The Company uses historical loss factors as one factor in determining the inherent loss that may be present in its loan portfolio. Actual losses could differ significantly from the historical factors that the Company uses. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of the Company's transactions would be the same, the timing of events that would impact its transactions could change.

---

**Table of Contents**

Certain reclassifications have been made to prior period balances to conform to the current period presentation.

In preparing these financial statements, the Company has evaluated subsequent events and transactions for potential recognition or disclosure through the date the financial statements were issued.

**Recent Accounting Pronouncements**

In January 2010, the FASB issued ASU 2010-04, *Accounting for Various Technical Corrections to SEC Paragraphs*. ASU 2010-04 makes technical corrections to existing SEC guidance including accounting for subsequent investments, termination of an interest rate swap, issuance of financial statements, subsequent events, use of the residual method to value acquired assets other than goodwill, adjustments in assets and liabilities for holding gains and losses, and selections of the discount rate used for measuring defined benefit obligations. The Company adopted this guidance without a material impact on its consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures* (Topic 820), improving disclosures about fair value measurements. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures and require new disclosures and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company adopted this guidance with no impact on its consolidated financial statements.

In February 2010, the FASB issued ASU 2010-09, *Amendments to Certain Recognitions and Disclosure Requirements* (Subtopic 855-10 - *Subsequent Events*). This guidance addresses subsequent events evaluation and the dates through which subsequent events were evaluated. This guidance is effective immediately and prospectively, except for guidance related to conduit debt, which is effective for interim or annual periods ending after June 15, 2010. The Company adopted this guidance with no impact on its consolidated financial statements.

In April 2010, the FASB issued ASU 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan is Part of A Pool That Is Accounted for as a Single Asset*. ASU 2010-18 provides that modifications of loans that are accounted for within a pool under Subtopic 310-30 do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loans is included is impaired if expected cash flows for the pool change. This guidance is effective prospectively for the first interim and annual period ending on or after July 15, 2010. Early adoption is permitted. The Company adopted this guidance without a material impact on its consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310): Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The objective of this ASU is for an entity to provide disclosures that facilitate financial statement users' evaluation of the nature of credit risk inherent in the entity's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes and reasons for those changes in the allowance for credit losses. Disclosures should be provided based on portfolio segment and class of financing receivable. Additional disclosures by class of financing receivable will be required relating to credit quality indicators, aging of past due financing receivables, and the nature and extent of troubled debt restructurings during the period. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

**Table of Contents****Restatement of Previously Issued September 30, 2009 Financials**

The Company has restated certain information in its consolidated financial statements for the period ended September 30, 2009 in order to reflect the appropriate accounting treatment for the assets that the Company acquired in the SFSB transaction based on additional information obtained during the fourth quarter of 2009. See Notes 4 and 5 for additional information with respect to the accounting for the covered loans and the FDIC indemnification asset.

In its Quarterly Report on Form 10-Q for the period ended September 30, 2009, the Company had presented these items as a component of total loans rather than segregating between covered loans and the FDIC indemnification asset because the prescribed accounting treatment under FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, allows the acquirer one year to develop and implement the related accounting associated with the acquisition. As part of this allowed accounting treatment, the gain on the transaction has also been adjusted. In connection with responses to comments from the SEC, the Company has informed the SEC that it would revise its consolidated financial statements for the period ended September 30, 2009 in any amended and/or future filings to reflect the proper accounting treatment, as presented in this Form 10-Q.

**2. SECURITIES**

Amortized costs and fair values of securities available for sale and held to maturity at September 30, 2010 and December 31, 2009 were as follows (dollars in thousands):

|  | Amortized<br>Cost | September 30, 2010<br>Gross Unrealized |                | Fair<br>Value     |
|--|-------------------|--|----------------|-------------------|
|  |                   | Gains                                  | Losses         |                   |
| <b>Securities Available for Sale</b>                   |                   |  |                |                   |
| U.S. Treasury issue and other U.S. Government agencies | \$ 23,253         | \$ 693                                 | \$             | \$ 23,946         |
| State, county and municipal                            | 125,555           | 7,309                                  | (44)           | 132,820           |
| Corporate and other bonds                              | 2,052             | 169                                    |                | 2,221             |
| Mortgage backed securities                             | 76,017            | 2,057                                  |                | 78,074            |
| Financial institution securities                       | 54                |  | (27)           | 27                |
| <b>Total Securities Available for Sale</b>             | <b>\$ 226,931</b> | <b>\$ 10,228</b>                       | <b>\$ (71)</b> | <b>\$ 237,088</b> |
| <b>Securities Held to Maturity</b>                     |                   |  |                |                   |
| U.S. Treasury issue and other U.S. Government agencies | \$                | \$                                     | \$             | \$                |
| State, county and municipal                            | 13,076            | 1,231                                  |                | 14,307            |
| Corporate and other bonds                              | 1,008             | 11                                     |                | 1,019             |
| Mortgage backed securities                             | 77,681            | 3,533                                  |                | 81,214            |
| <b>Total Securities Held to Maturity</b>               | <b>\$ 91,765</b>  | <b>\$ 4,775</b>                        | <b>\$</b>      | <b>\$ 96,540</b>  |

**Table of Contents**

|  | Amortized<br>Cost | December 31, 2009<br>Gross Unrealized |                 | Fair<br>Value     |
|--|-------------------|---------------------------------------|-----------------|-------------------|
|  |                   | Gains                                 | Losses          |                   |
| <b>Securities Available for Sale</b>                   |                   |                                       |                 |                   |
| U.S. Treasury issue and other U.S. Government agencies | \$ 17,393         | \$ 434                                | \$ (1)          | \$ 17,826         |
| State, county and municipal                            | 104,831           | 1,864                                 | (557)           | 106,138           |
| Corporate and other bonds                              | 1,511             | 93                                    |                 | 1,604             |
| Mortgage backed securities                             | 51,434            | 1,573                                 | (3)             | 53,004            |
| Financial institution securities                       | 1,192             | 113                                   | (437)           | 868               |
| <b>Total Securities Available for Sale</b>             | <b>\$ 176,361</b> | <b>\$ 4,077</b>                       | <b>\$ (998)</b> | <b>\$ 179,440</b> |
| <b>Securities Held to Maturity</b>                     |                   |                                       |                 |                   |
| U.S. Treasury issue and other U.S. Government agencies | \$ 748            | \$ 2                                  | \$              | \$ 750            |
| State, county and municipal                            | 13,097            | 516                                   | (4)             | 13,609            |
| Corporate and other bonds                              | 1,024             | 29                                    |                 | 1,053             |
| Mortgage backed securities                             | 98,296            | 3,308                                 | (8)             | 101,596           |
| <b>Total Securities Held to Maturity</b>               | <b>\$ 113,165</b> | <b>\$ 3,855</b>                       | <b>\$ (12)</b>  | <b>\$ 117,008</b> |

The amortized cost and fair value of securities as of September 30, 2010 by contractual maturity are shown below (dollars in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without any penalties.

|  | Held to Maturity  |                  | Available for Sale |                   |
|--|-------------------|------------------|--------------------|-------------------|
|  | Amortized<br>Cost | Fair<br>Value    | Amortized<br>Cost  | Fair<br>Value     |
| Due in one year or less                | \$ 2,511          | \$ 2,524         | \$ 14,029          | \$ 14,375         |
| Due after one year through five years  | 53,816            | 56,206           | 73,123             | 75,559            |
| Due after five years through ten years | 33,559            | 35,833           | 108,431            | 113,597           |
| Due after ten years                    | 1,879             | 1,977            | 31,294             | 33,530            |
|  | 91,765            | 96,540           | 226,877            | 237,061           |
| Financial institution securities       |                   |                  | 54                 | 27                |
| <b>Total securities</b>                | <b>\$ 91,765</b>  | <b>\$ 96,540</b> | <b>\$ 226,931</b>  | <b>\$ 237,088</b> |

Gains and losses on the sale of securities are recorded on the settlement date and are determined using the specific identification method. Gross realized gains and losses on sales and other than temporary impairments ( OTTI ) on securities available for sale during the periods were as follows (dollars in thousands):

|                            | Three Months Ended September 30 |        | Nine Months Ended September 30 |          |
|----------------------------|---------------------------------|--------|--------------------------------|----------|
|                            | 2010                            | 2009   | 2010                           | 2009     |
| Gross realized gains       | \$ 89                           | \$ 635 | \$ 525                         | \$ 1,041 |
| Gross realized losses      | 385                             | 23     | 460                            | 136      |
| OTTI                       |                                 |        | 459                            |          |
| Net securities gain (loss) | \$ (296)                        | \$ 612 | \$ (394)                       | \$ 905   |





**Table of Contents**

In estimating OTTI losses, management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and short-term prospects for the issuer, and the intent and ability of management to hold its investment for a period of time to allow a recovery in fair value. At September 30, 2010, the financial institution securities were deemed to have impairment losses that were other than temporary in nature in the amount of \$459,000, as management does not intend to hold them until they recover their value. At December 31, 2009, there were no investments held that had impairment losses other than temporary in nature.

The fair value and gross unrealized losses for securities, segregated by the length of time that individual securities have been in a continuous gross unrealized loss position, at September 30, 2010 and December 31, 2009 were as follows (dollars in thousands):

|  | Less than 12 Months |                 | September 30, 2010<br>12 Months or More |                 | Total      |                 |
|--|---------------------|-----------------|---|-----------------|------------|-----------------|
|  | Fair Value          | Unrealized Loss | Fair Value                              | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury issue and other U.S. Government agencies | \$                  | \$              | \$                                      | \$              | \$         | \$              |
| State, county and municipal                            | 304                 | (7)             | 602                                     | (37)            | 906        | (44)            |
| Corporate and other bonds                              |                     |                 |   |                 |            |                 |
| Mortgage backed securities                             |                     |                 |   |                 |            |                 |
| Financial institution securities                       | 54                  | (27)            |   |                 | 54         | (27)            |
| Total  | \$ 358              | \$ (34)         | \$ 602                                  | \$ (37)         | \$ 960     | \$ (71)         |

|  | Less than 12 Months |                 | December 31, 2009<br>12 Months or More |                 | Total      |                 |
|--|---------------------|-----------------|--|-----------------|------------|-----------------|
|  | Fair Value          | Unrealized Loss | Fair Value                             | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury issue and other U.S. Government agencies | \$ 1,078            | \$ (1)          | \$                                     | \$              | \$ 1,078   | \$ (1)          |
| State, county and municipal                            | 25,771              | (514)           | 1,948                                  | (47)            | 27,719     | (561)           |
| Mortgage backed securities                             | 4,897               | (8)             | 615                                    | (3)             | 5,512      | (11)            |
| Financial institution securities                       | 1,127               | (437)           |  |                 | 1,127      | (437)           |
| Total  | \$ 32,873           | \$ (960)        | \$ 2,563                               | \$ (50)         | \$ 35,436  | \$ (1,010)      |

The unrealized losses in the investment portfolio at September 30, 2010 are generally a result of market fluctuations that occur daily. The unrealized losses are from 4 securities that are all of investment grade and may be backed by insurance, U.S. government agency guarantees, or the full faith and credit of local municipalities throughout the United States. The Company has the ability to, and believes it is more likely than not it will, hold these securities until they recover in value, with the exception of the financial institution securities that were sold subsequent to quarter end for a loss of \$27,000. Market prices are affected by conditions beyond the control of the Company. Investment decisions are made by the management group of the Company and reflect the overall liquidity and strategic asset/liability objectives of the Company. Management analyzes the securities portfolio frequently and manages the portfolio to provide an overall positive impact to the Company's income statement and balance sheet.

Securities with amortized costs of \$39.8 million and \$30.1 million at September 30, 2010 and December 31, 2009, respectively, were pledged to secure deposits and for other purposes required or permitted by law.

**Table of Contents****3. LOANS NOT COVERED BY FDIC SHARED LOSS AGREEMENT (NON-COVERED LOANS)**

The Company's non-covered loans at September 30, 2010 and December 31, 2009 were comprised of the following (dollars in thousands):

|  | September 30, 2010 |                        | December 31, 2009 |                        |
|--|--------------------|------------------------|-------------------|------------------------|
|  | Amount             | % of Non-Covered Loans | Amount            | % of Non-Covered Loans |
| <b>Mortgage loans on real estate:</b>            |                    |                        |                   |                        |
| Residential 1-4 family                           | \$ 144,319         | 26.34%                 | \$ 146,141        | 25.22%                 |
| Commercial                                       | 210,812            | 38.48                  | 188,991           | 32.62                  |
| Construction and land development                | 110,581            | 20.18                  | 144,297           | 24.91                  |
| Second mortgages                                 | 11,093             | 2.02                   | 13,935            | 2.41                   |
| Multifamily                                      | 10,754             | 1.96                   | 11,995            | 2.07                   |
| Agriculture                                      | 4,030              | 0.74                   | 5,516             | 0.95                   |
| <b>Total real estate loans</b>                   | <b>491,589</b>     | <b>89.72</b>           | <b>510,875</b>    | <b>88.18</b>           |
| Commercial loans                                 | 43,980             | 8.03                   | 42,157            | 7.28                   |
| Consumer installment loans                       | 10,223             | 1.87                   | 14,145            | 2.44                   |
| All other loans                                  | 2,087              | 0.38                   | 12,205            | 2.10                   |
| <b>Gross loans</b>                               | <b>547,879</b>     | <b>100.00%</b>         | <b>579,382</b>    | <b>100.00%</b>         |
| <b>Less unearned income on loans</b>             | <b>(370)</b>       |                        | <b>(753)</b>      |                        |
| <b>Non-covered loans, net of unearned income</b> | <b>\$ 547,509</b>  |                        | <b>\$ 578,629</b> |                        |

At September 30, 2010 and December 31, 2009, the Company's allowance for credit losses was comprised of the following: (i) specific valuation allowances calculated in accordance with FASB ASC 310, *Receivables*, (ii) general valuation allowances calculated in accordance with FASB ASC 450, *Contingencies*, based on economic conditions and other qualitative risk factors, and (iii) historical valuation allowances calculated using historical loan loss experience. Management identified loans subject to impairment in accordance with ASC 310.

At September 30, 2010 and December 31, 2009, a portion of the construction and land development loans presented above contain interest reserve provisions. The Company follows standard industry practice to include interest reserves and capitalized interest in a construction loan. This practice recognizes interest as an additional cost of the project and, as a result, requires the borrower to put additional equity into the project. In order to monitor the project throughout its life to make sure the property is moving along as planned to ensure appropriateness of continuing to capitalize interest, the Company coordinates an independent property inspection in connection with each disbursement of loan funds. Until completion, there is generally no cash flow from which to make the interest payment. The Company does not advance additional interest reserves to keep a loan from becoming nonperforming.

For the three months ended September 30, 2010, the total amount of interest reserves recognized as interest income on construction loans with interest reserves, all of which was capitalized interest recorded in the Company's loan portfolio, was \$118,000. For the nine months ended September 30, 2010, this amount was \$584,000. There were no construction loans with interest reserves that were nonperforming at September 30, 2010.

**Table of Contents**

The following is a summary of information for impaired and nonaccrual loans at September 30, 2010, December 31, 2009 and September 30, 2009 for non-covered loans (dollars in thousands):

|   | September 30,<br>2010 | December 31,<br>2009 | September 30,<br>2009 |
|---|-----------------------|----------------------|-----------------------|
| Impaired loans without a valuation allowance            | \$ 63,782             | \$ 23,109            | \$ 27,728             |
| Impaired loans with a valuation allowance               | 63,342                | 33,347               | 26,776                |
| <b>Total impaired loans</b>                             | <b>\$ 127,124</b>     | <b>\$ 56,456</b>     | <b>\$ 54,504</b>      |
| Valuation allowance related to impaired loans           | \$ 18,233             | \$ 8,779             | \$ 9,454              |
| <b>Total nonaccrual loans</b>                           | <b>43,298</b>         | <b>20,011</b>        | <b>20,572</b>         |
| Total loans 90 days or more past due and still accruing | 35                    | 247                  | 1,462                 |

Average investment in impaired loans was \$96.8 million and \$43.0 million for the periods ended September 30, 2010 and 2009, respectively. Interest income on nonaccrual loans, if recognized, is recorded using the cash basis method of accounting. There were no amounts recognized during the three or nine months ended September 30, 2010 and 2009. For the three months ended September 30, 2010 and 2009, estimated interest income of \$895,000 and \$321,000, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms. For the nine months ended September 30, 2010 and 2009, estimated interest income of \$2.0 million and \$787,000, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms.

Activity in the allowance for loan losses on non-covered loans for the three months ended September 30, 2010 and September 30, 2009 and the nine months ended September 30, 2010 and September 30, 2009 was comprised of the following (dollars in thousands):

|                                   | Three months<br>ended<br>September 30, 2010 | Three months<br>ended<br>September 30, 2009 | Nine months<br>ended<br>September 30, 2010 | Nine months<br>ended<br>September 30, 2009 |
|-----------------------------------|---|---|--|--|
| Beginning allowance               | \$ 38,785                                   | \$ 12,185                                   | \$ 18,169                                  | \$ 6,939                                   |
| Provision for loan losses         | 1,116                                       | 5,231                                       | 26,560                                     | 11,271                                     |
| Recoveries of loans charged off   | 99  | 224   | 786  | 306  |
| Loans charged off                 | (5,647)                                     | (1,429)                                     | (11,162)                                   | (2,305)                                    |
| <b>Allowance at end of period</b> | <b>\$ 34,353</b>                            | <b>\$ 16,211</b>                            | <b>\$ 34,353</b>                           | <b>\$ 16,211</b>                           |

**Table of Contents**

The following tables present charge-offs and recoveries for non-covered loans by loan category for the three months ended September 30, 2010 and September 30, 2009 and the nine months ended September 30, 2010 and September 30, 2009 (dollars in thousands):

|                                   | Three months ended September 30, 2010 |            |                 | Three months ended September 30, 2009 |            |                 |
|-----------------------------------|---------------------------------------|------------|-----------------|---------------------------------------|------------|-----------------|
|                                   | Charge-offs                           | Recoveries | Net Charge-offs | Charge-offs                           | Recoveries | Net Charge-offs |
| Mortgage loans on real estate:    |                                       |            |                 |                                       |            |                 |
| Residential 1-4 family            | \$ 628                                | \$         | \$ 628          | \$                                    | \$         | \$              |
| Commercial                        | 410                                   | (3)        | 407             | 814                                   |            | 814             |
| Construction and land development | 4,115                                 | (56)       | 4,059           | 583                                   | (183)      | 400             |
| Second mortgages                  | 59                                    |            | 59              |                                       |            |                 |
| Multifamily                       |                                       |            |                 |                                       |            |                 |
| Agriculture                       |                                       |            |                 |                                       |            |                 |
| Total real estate loans           | 5,212                                 | (59)       | 5,153           | 1,397                                 | (183)      | 1,214           |
| Commercial loans                  | 382                                   | (21)       | 361             |                                       | (17)       | (17)            |
| Consumer installment loans        | 23                                    | (4)        | 19              | 4                                     | (11)       | (7)             |
| All other loans                   | 30                                    | (15)       | 15              | 28                                    | (13)       | 15              |
| Total non-covered loans           | \$ 5,647                              | \$ (99)    | \$ 5,548        | \$ 1,429                              | \$ (224)   | \$ 1,205        |

|                                   | Nine months ended September 30, 2010 |            |                 | Nine months ended September 30, 2009 |            |                 |
|-----------------------------------|--------------------------------------|------------|-----------------|--------------------------------------|------------|-----------------|
|                                   | Charge-offs                          | Recoveries | Net Charge-offs | Charge-offs                          | Recoveries | Net Charge-offs |
| Mortgage loans on real estate:    |                                      |            |                 |                                      |            |                 |
| Residential 1-4 family            | \$ 1,235                             | \$         | \$ 1,235        | \$ 276                               | \$         | \$ 276          |
| Commercial                        | 1,186                                | (502)      | 684             | 814                                  |            | 814             |
| Construction and land development | 6,889                                | (56)       | 6,833           | 652                                  | (199)      | 453             |
| Second mortgages                  | 360                                  | (79)       | 281             | 34                                   |            | 34              |
| Multifamily                       | 375                                  |            | 375             |                                      |            |                 |
| Agriculture                       |                                      |            |                 |                                      |            |                 |
|                                   |                                      |            |                 | 13                                   |            | 13              |
| Total real estate loans           | 10,045                               | (637)      | 9,408           | 1,789                                | (199)      | 1,590           |
| Commercial loans                  | 800                                  | (80)       | 720             | 318                                  | (20)       | 298             |
| Consumer installment loans        | 219                                  | (17)       | 202             | 170                                  | (74)       | 96              |
| All other loans                   |                                      |            |                 |                                      |            |                 |
|                                   | 98                                   | (52)       | 46              | 28                                   | (13)       | 15              |
| Total non-covered loans           | \$ 11,162                            | \$ (786)   | \$ 10,376       | \$ 2,305                             | \$ (306)   | \$ 1,999        |



**Table of Contents**

**4. LOANS COVERED BY FDIC SHARED LOSS AGREEMENT (COVERED LOANS)**

The Company is applying the provisions of FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, to all loans acquired in the SFSB acquisition (the covered loans).

As of September 30, 2010 and December 31, 2009, the outstanding balance of the covered loans was \$200.9 million and \$242.0 million, respectively. The carrying amount, by loan type, as of these dates is as follows (dollars in thousands):

|                                   | September 30, 2010 |                    | December 31, 2009 |                    |
|-----------------------------------|--------------------|--------------------|-------------------|--------------------|
|                                   | Amount             | % of Covered Loans | Amount            | % of Covered Loans |
| Mortgage loans on real estate:    |                    |                    |                   |                    |
| Residential 1-4 family            | \$ 104,358         | 84.73%             | \$ 119,065        | 78.88%             |
| Commercial                        | 4,316              | 3.50               | 5,835             | 3.87               |
| Construction and land development | 6,761              | 5.49               | 17,020            | 11.28              |
| Second mortgages                  | 7,539              | 6.12               | 8,194             | 5.43               |
| Multifamily                       | 92                 | 0.07               |                   |                    |
| Agriculture                       |                    |                    | 627               | 0.41               |
| Total real estate loans           | 123,066            | 99.91              | 150,741           | 99.87              |
| Commercial loans                  |                    |                    |                   |                    |
| Consumer installment loans        | 106                | 0.09               | 194               | 0.13               |
| All other loans                   |                    |                    |                   |                    |
| Gross covered loans               | \$ 123,172         | 100.00%            | \$ 150,935        | 100.00%            |

Activity in the allowance for loan losses on covered loans for the three months ended September 30, 2010 and September 30, 2009 and the nine months ended September 30, 2010 and September 30, 2009 was comprised of the following (dollars in thousands):

|                                 | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---------------------------------|---------------------------------------|---------------------------------------|--------------------------------------|--------------------------------------|
| Beginning allowance             | \$ 829                                | \$                                    | \$                                   | \$                                   |
| Provision for loan losses       |                                       |                                       | 880                                  |                                      |
| Recoveries of loans charged off |                                       |                                       | 205                                  |                                      |
| Loans charged off               |                                       |                                       | (256)                                |                                      |
| Allowance at end of period      | \$ 829                                | \$                                    | \$ 829                               | \$                                   |

**Table of Contents**

The following table presents charge-offs and recoveries for covered loans by loan category for the nine months ended September 30, 2010 and September 30, 2009. There were no charge-offs or recoveries for the three months ended September 30, 2010 and September 30, 2009 (dollars in thousands):

|                                   | Nine months ended September 30, 2010 |            |                 | Nine months ended September 30, 2009 |            |                 |
|-----------------------------------|--------------------------------------|------------|-----------------|--------------------------------------|------------|-----------------|
|                                   | Charge-offs                          | Recoveries | Net Charge-offs | Charge-offs                          | Recoveries | Net Charge-offs |
| Mortgage loans on real estate:    |                                      |            |                 |                                      |            |                 |
| Residential 1-4 family            | \$                                   | \$         | \$              | \$                                   | \$         | \$              |
| Commercial                        |                                      |            |                 |                                      |            |                 |
| Construction and land development | 256                                  | (205)      | 51              |                                      |            |                 |
| Second mortgages                  |                                      |            |                 |                                      |            |                 |
| Multifamily                       |                                      |            |                 |                                      |            |                 |
| Agriculture                       |                                      |            |                 |                                      |            |                 |
| Total real estate loans           | 256                                  | (205)      | 51              |                                      |            |                 |
| Commercial loans                  |                                      |            |                 |                                      |            |                 |
| Consumer installment loans        |                                      |            |                 |                                      |            |                 |
| All other loans                   |                                      |            |                 |                                      |            |                 |
| Total non-covered loans           | \$ 256                               | \$ (205)   | \$ 51           | \$                                   | \$         | \$              |

The change in the accretable yield balance for the nine months ended September 30, 2010 and the year ended December 31, 2009 is as follows (dollars in thousands):

|   |           |
|---|-----------|
| Balance, January 1, 2009                        | \$        |
| Additions                                       | 61,023    |
| Accretion                                       | (15,139)  |
| Reclassification from (to) Non-accretable Yield | 10,908    |
| Balance, December 31, 2009                      | 56,792    |
| Additions                                       |           |
| Accretion                                       | (10,671)  |
| Reclassification from (to) Non-accretable Yield | 26,934    |
| Balance, September 30, 2010                     | \$ 73,055 |

The covered loans are not classified as nonperforming assets as of September 30, 2010, as the loans are accounted for on a pooled basis, and interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all purchased loans. As of September 30, 2010, there was an allowance for loan losses recorded on covered loans of \$829,000. This allowance is the result of a change in the timing of expected cash flows for one of the covered loan pools. There was no allowance for loan losses recorded on the covered loan pools as of December 31, 2009.



**Table of Contents****5. FDIC AGREEMENTS AND FDIC INDEMNIFICATION ASSET**

On January 30, 2009, the Company entered into a Purchase and Assumption Agreement with the FDIC to assume all of the deposits and certain other liabilities and acquire substantially all of the assets of SFSB. Under the shared loss agreements that are part of that agreement, the FDIC will reimburse the Bank for 80% of losses arising from covered loans and foreclosed real estate assets on the first \$118 million in losses of such covered loans and foreclosed real estate assets and for 95% of losses on covered loans and foreclosed real estate assets thereafter. Under the shared loss agreements, a loss on a covered loan or foreclosed real estate is defined generally as a realized loss incurred through a permitted disposition, foreclosure, short-sale or restructuring of the covered loan or foreclosed real estate. The reimbursements for losses on single family one-to-four residential mortgage loans are to be made monthly until the end of the month in which the tenth anniversary of the closing of the SFSB transaction occurs, and the reimbursements for losses on other covered assets are to be made quarterly until the end of the quarter in which the eighth anniversary of the closing of the SFSB transaction occurs. The shared loss agreements provide for indemnification from the first dollar of losses without any threshold requirement. The reimbursable losses from the FDIC are based on the book value of the relevant loan as determined by the FDIC at the date of the SFSB transaction. New loans made after that date are not covered by the shared loss agreements. The carrying value of the shared loss agreements is detailed below.

In accordance with FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, the fair value of the shared loss agreements is recorded as an asset (FDIC indemnification asset) on the Company's consolidated balance sheet. The fair value was estimated using projected cash flows available for loss sharing based on the credit adjustments estimated for each loan pool and other real estate owned and the loss sharing percentages outlined in the purchase and assumption agreement with the FDIC. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC.

Because the acquired loans are subject to a shared loss agreement and the corresponding indemnification asset exists to represent the value of expected payments from the FDIC, increases and decreases in loan accretable yield due to changing loss expectations will also have an impact on the valuation of the FDIC indemnification asset. Improvement in loss expectations will typically increase loan accretable yield and decrease the value of the FDIC indemnification asset and, in some instances, result in an amortizable premium on the FDIC indemnification asset. Increases in loss expectations will typically be recognized as impairment in the current period through allowance for loan losses while resulting in additional non-interest income for the amount of the increase in the FDIC indemnification asset.

The following tables present the balances of the FDIC indemnification asset related to the SFSB transaction at September 30, 2010 and December 31, 2009 (dollars in thousands):

|   | September 30, 2010 | December 31, 2009 |
|---|--------------------|-------------------|
| Anticipated realizable loss                               | \$ 63,293          | \$ 88,943         |
| Estimated loss sharing value                              | 50,634             | 71,090            |
| Premium to be accreted over the life of the covered loans | 10,536             | 5,017             |
| FDIC indemnification asset balance                        | \$ 61,170          | \$ 76,107         |

**Table of Contents****6. MERGERS AND ACQUISITIONS**

On January 30, 2009, the Bank acquired substantially all assets and assumed all deposit and certain other liabilities relating to seven former branch offices of SFSB in Maryland. The transaction was consummated pursuant to a Purchase and Assumption Agreement by and among the FDIC, as Receiver for SFSB, and the Bank.

Pursuant to the terms of the Purchase and Assumption Agreement, the Bank assumed approximately \$303 million in deposits, all of which were deemed to be core deposits and maintain their current insurance coverage. The Bank also acquired approximately \$362 million in loans (based on contract value) and other assets. The Bank bid a negative \$45 million for the net assets acquired.

The Bank entered into shared loss agreements with the FDIC with respect to certain covered assets acquired. See Notes 4 and 5 for additional information related to certain assets covered under the FDIC shared loss agreements.

In relation to this acquisition, the Company followed the acquisition method of accounting as outlined in FASB ASC 805, *Business Combinations*. Management relied on external analyses by appraisers in determining the fair value of assets acquired and liabilities assumed. The following table provides the allocation of the negative bid in the financial statements, based on those analyses (dollars in thousands):

|   | <b>SFSB</b> |
|---|-------------|
| Negative bid on SFSB transaction                        | \$ 45,000   |
| Adjustments to assets acquired and liabilities assumed: |             |
| Fair value adjustments:                                 |             |
| Loans   | (102,011)   |
| Foreclosed real estate                                  | (10,428)    |
| FDIC indemnification asset                              | 84,584      |
| Deposits  | (1,455)     |
| Core deposit intangible                                 | 2,158       |
| Other adjustments                                       | 2,407       |
| Net assets acquired, pre-tax                            | 20,255      |
| Deferred tax liability                                  | (6,886)     |
| Net assets acquired, net of tax                         | \$ 13,369   |
| Fair value of assets acquired                           |             |
| Cash and cash equivalents                               | \$ 54,717   |
| Investment securities                                   | 4,954       |
| Loans receivable  | 198,253     |
| Foreclosed real estate                                  | 9,416       |
| FDIC indemnification asset                              | 84,584      |
| Other assets  | 10,369      |
| Fair value of assets acquired                           | \$ 362,293  |
| Fair value of liabilities assumed                       |             |
| Deposits  | \$ 302,756  |
| FHLB advances   | 37,525      |
| Deferred taxes  | 6,886       |
| Other liabilities                                       | 1,757       |

Edgar Filing: Community Bankers Trust Corp - Form 10-Q

|                                   |            |
|-----------------------------------|------------|
| Fair value of liabilities assumed | \$ 348,924 |
| Net assets acquired at fair value | \$ 13,369  |

## **Table of Contents**

As a result of the acquisition of the operations of SFSB, the Company recorded a gain of \$20.3 million in the first quarter of 2009 represented by net assets acquired, pre-tax.

The Company engaged two external firms to assess credit quality and fair market value of the loan portfolio. An external firm performed a 100% credit review on the entire portfolio and classified each of the loans into several homogenous pools of credit risk and levels of impairment. An external firm specializing in fair market valuations then used the credit review results to determine the current fair market as defined in ASC 820, *Fair Value Measurements and Disclosures*. The fair value assessment was based on several measures, including asset quality, contractual interest rates, current market interest rates, and other underlying factors and the analysis divided the portfolio into the following segments:

Acquisition, development, and construction loans

Residential first mortgage loans

Consumer real estate loans

Commercial real estate loans

The following three general approaches were used in the valuation analyses the asset-based approach, the market approach, and the income approach.

Certificate of deposits (CDs) and the core deposit intangible (premium paid to acquire the core deposits of SFSB) were marked to market using a third-party analysis of cash flow, interest rate, maturity dates or weighted average life, balances, attrition rates, and current market rates.

The Company reviewed certain contracts between SFSB and its vendors in order to identify any efficiencies from the acquisition through contract cancellation. The costs of cancelling certain contracts were not material enough to change the amount of the gain recorded.

Supplemental pro forma information reflecting the revenue and earnings of the combined entity for the current reporting period as though the acquisition date for the business combination had occurred at the beginning of the annual reporting period, and similar comparative information for the prior year, has not been disclosed. Management has determined that it is impracticable to provide this information due to a lack of reliability of financial information produced by SFSB prior to the acquisition and the costs that would be incurred to reproduce the information with an appropriate level of reliability.

## **7. GOODWILL AND OTHER INTANGIBLES**

Significant amounts of goodwill and other intangible assets were recorded in connection with the TFC and BOE mergers as of May 31, 2008. In accordance with ASC 350, *Intangibles - Goodwill and Other*, goodwill was initially assessed for potential impairment as of May 31, 2009, the anniversary date of the mergers, and again as of December 31, 2009, resulting in impairment charges totaling \$31.5 million.

**Table of Contents**

Economic conditions, evidenced by the significant loan loss provision taken during the second quarter, warranted an impairment evaluation of goodwill that resulted in \$5.7 million in impairment charges for the quarter ended June 30, 2010. In determining a conclusion of value for the reporting unit, the guideline transactions method received 25% of the total weight (placed on tangible book value), the transaction value method received 25%, and the discounted cash flow method received 50%. This weighting methodology reflected equal consideration of the transaction value and guideline transactions methods, which are market approaches that rely on transactions in the Company's stock and comparable banks acquired in recent acquisitions, and the discounted cash flow method, which represents a value based on the future cash flows generated by the reporting unit.

The material assumptions used and the sensitivity in them for the three valuation methods used are as follows:

The guideline transactions method derived the fair value of the reporting unit using (a) the reporting unit's tangible book value at May 31, 2010 and (b) multiples of tangible book value derived from marketplace transactions, as reported by SNL Financial. The multiples were derived from two groups of transactions (a) transactions announced between September 30, 2008 and May 31, 2010 involving target banks located nationwide with assets between \$250 million and \$5 billion and (b) transactions announced between September 30, 2008 and May 31, 2010 involving target banks located in the Mid-Atlantic region. A change in the price/tangible book value multiple by 10% would affect the value by approximately 10%.

The transaction value method derived the fair value of the reporting unit using (a) the Company's closing price per share at May 31, 2010, (b) the number of common shares outstanding, and (c) a control premium. The control premium was estimated based upon an analysis of implied control premiums for bank transactions announced in 2010 and also over a longer time period from year-end 2005 through 2010. A change in the control premium applied by 10% would affect the value by approximately 2%.

The discounted cash flow method was prepared in a manner consistent with the May 31, 2009 (as discussed in the Company's Annual Report on Form 10-K for the period ended December 31, 2009) analysis and includes assumptions as to (a) the reporting unit's future income statements and balance sheets, (b) the terminal multiple of earnings or tangible book value, and (c) the discount rate.

Core deposit intangible assets are amortized over the period of expected benefit, ranging from 2.6 to 9 years. Core deposit intangibles are recognized, amortized and evaluated for impairment as required by ASC 350. As a result of the mergers with TFC and BOE, the Company recorded \$15.0 million in core deposit intangible assets. Core deposit intangibles resulting from the Georgia and Maryland transactions equaled \$3.2 million and \$2.2 million, respectively, and will be amortized over approximately 9 years.

Goodwill and other intangible assets are presented in the following table (dollars in thousands):

|                            | <b>Goodwill</b> | <b>Core Deposit<br/>Intangibles</b> |
|----------------------------|-----------------|-------------------------------------|
| Balance December 31, 2009  | \$ 5,727        | \$ 17,080                           |
| Amortization               |                 | (1,696)                             |
| Impairment                 | (5,727)         |                                     |
| Balance September 30, 2010 | \$              | \$ 15,384                           |

**Table of Contents**

|                            | <b>Goodwill</b> | <b>Core Deposit<br/>Intangibles</b> |
|----------------------------|-----------------|-------------------------------------|
| Balance December 31, 2008  | \$ 37,184       | \$ 17,163                           |
| Acquisition of SFSB        |                 | 2,158                               |
| Amortization               |                 | (1,675)                             |
| Impairment                 | (24,032)        |                                     |
| Balance September 30, 2009 | \$ 13,152       | \$ 17,646                           |

**8. DEPOSITS**

The following table provides interest bearing deposit information, by type, as of September 30, 2010 and December 31, 2009 (dollars in thousands):

|                                   | <b>September 30, 2010</b> | <b>December 31, 2009</b> |
|-----------------------------------|---------------------------|--------------------------|
| NOW                               | \$ 97,361                 | \$ 94,711                |
| MMDA                              | 127,905                   | 113,071                  |
| Savings                           | 62,393                    | 58,373                   |
| Time deposits less than \$100,000 | 396,315                   | 423,902                  |
| Time deposits \$100,000 and over  | 264,277                   | 279,147                  |
| Total interest bearing deposits   | \$ 948,251                | \$ 969,204               |

**9. FAIR VALUES OF ASSETS AND LIABILITIES**

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs and also establishes a fair value hierarchy that prioritizes the valuation inputs into three broad levels. The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is determined using model-based techniques with significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of third party pricing services, option pricing models, discounted cash flow models and similar techniques.

FASB ASC 825, *Financial Instruments*, allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Company has not made any material ASC 825 elections as of September 30, 2010.

**Table of Contents****Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

The Company utilizes fair value measurements to record adjustments to certain assets to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis (dollars in thousands).

|   | <b>September 30, 2010</b> |                  |                   |                |
|---|---------------------------|------------------|-------------------|----------------|
|   | <b>Total</b>              | <b>Level 1</b>   | <b>Level 2</b>    | <b>Level 3</b> |
| <b>Investment securities available for sale</b>       |                           |                  |                   |                |
| U.S. Treasury issue and U.S. government agencies      | \$ 23,946                 | \$ 10,999        | \$ 12,947         | \$             |
| State, county, and municipal                          | 132,820                   | 1,994            | 130,826           |                |
| Corporate and other bonds                             | 2,221                     |                  | 2,221             |                |
| Mortgage backed securities                            | 78,074                    |                  | 78,074            |                |
| Financial institution securities                      | 27                        | 27               |                   |                |
| <b>Total investment securities available for sale</b> | <b>237,088</b>            | <b>13,020</b>    | <b>224,068</b>    |                |
| <b>Total assets at fair value</b>                     | <b>\$ 237,088</b>         | <b>\$ 13,020</b> | <b>\$ 224,068</b> | <b>\$</b>      |
| <b>Total liabilities at fair value</b>                | <b>\$</b>                 | <b>\$</b>        | <b>\$</b>         | <b>\$</b>      |

|   | <b>December 31, 2009</b> |                  |                   |                |
|---|--------------------------|------------------|-------------------|----------------|
|   | <b>Total</b>             | <b>Level 1</b>   | <b>Level 2</b>    | <b>Level 3</b> |
| <b>Investment securities available for sale</b>       |                          |                  |                   |                |
| U.S. Treasury issue and U.S. government agencies      | \$ 17,826                | \$ 5,137         | \$ 12,689         | \$             |
| State, county, and municipal                          | 106,138                  | 12,074           | 94,064            |                |
| Corporate and other bonds                             | 1,604                    |                  | 1,604             |                |
| Mortgage backed securities                            | 53,004                   |                  | 53,004            |                |
| Financial institution securities                      | 868                      | 868              |                   |                |
| <b>Total investment securities available for sale</b> | <b>179,440</b>           | <b>18,079</b>    | <b>161,361</b>    |                |
| <b>Total assets at fair value</b>                     | <b>\$ 179,440</b>        | <b>\$ 18,079</b> | <b>\$ 161,361</b> | <b>\$</b>      |
| <b>Total liabilities at fair value</b>                | <b>\$</b>                | <b>\$</b>        | <b>\$</b>         | <b>\$</b>      |

Investment securities available for sale are recorded at fair value each reporting period. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

The Company utilizes a third party vendor to provide fair value data for purposes of determining the fair value of its available for sale securities portfolio. The third party vendor uses a reputable pricing company for security market data. The third party vendor has controls and edits in place for month-to-month market checks and zero pricing and an AICPA Statement on Auditing Standard Number 70 (SAS 70) report is obtained from the third party vendor on an annual basis. The Company makes no adjustments to the pricing service data received for its securities available for sale.

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by

## Edgar Filing: Community Bankers Trust Corp - Form 10-Q

government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.



**Table of Contents****Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**

The Company is also required to measure and recognize certain other financial assets at fair value on a nonrecurring basis on the consolidated balance sheet. For assets measured at fair value on a nonrecurring basis in 2010 and still held on the consolidated balance sheet at September 30, 2010, the following table provides the fair value measures by level of valuation assumptions used for those assets.

|   | Total     | September 30, 2010 |           |           |
|---|-----------|--------------------|-----------|-----------|
|   |           | Level 1            | Level 2   | Level 3   |
| Impaired loans, non-covered                 | \$ 45,109 | \$                 | \$ 27,823 | \$ 17,286 |
| Other real estate owned (OREO), non-covered | 4,320     |                    |           | 4,320     |
| Other real estate owned (OREO), covered     | 10,104    |                    | 460       | 9,644     |
| Total assets at fair value                  | \$ 59,533 | \$                 | \$ 28,283 | \$ 31,250 |
| Total liabilities at fair value             | \$        | \$                 | \$        | \$        |

|   | Total     | December 31, 2009 |           |           |
|---|-----------|-------------------|-----------|-----------|
|   |           | Level 1           | Level 2   | Level 3   |
| Impaired loans, non-covered                 | \$ 24,568 | \$                | \$ 22,714 | \$ 1,854  |
| Other real estate owned (OREO), non-covered | 1,586     |                   | 1,586     |           |
| Other real estate owned (OREO), covered     | 12,822    |                   | 3,909     | 8,913     |
| Goodwill                                    | 5,727     |                   |           | 5,727     |
| Total assets at fair value                  | \$ 44,703 | \$                | \$ 28,209 | \$ 16,494 |
| Total liabilities at fair value             | \$        | \$                | \$        | \$        |

*Impaired loans, non-covered*

Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, *Receivables*. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. The Bank frequently obtains appraisals prepared by external professional appraisers for classified loans greater than \$250,000 when the most recent appraisal is greater than 12 months old. The appraisal, based on the date of preparation, becomes only a part of the determination of the amount of any loan write-off, with current market conditions and the collateral's location being other determinants. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan within Level 2.

The Company may also identify collateral deterioration based on current market sales data, including price and absorption, as well as input from real estate sales professionals and developers, county or city tax assessments, market data and on-site inspections by Company personnel. Internally prepared estimates generally result from current market data and actual sales data related to the Company's collateral or where the collateral is located. When management determines that the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. In instances where an appraisal received subsequent to an internally prepared estimate reflects a higher collateral value, management does not revise the carrying amount. Reviews of classified loans are performed by management on a quarterly basis.

*Other real estate owned, covered and non-covered*

## Edgar Filing: Community Bankers Trust Corp - Form 10-Q

Other real estate owned (OREO) assets are adjusted to fair value upon transfer of the related loans to OREO property. Subsequent to the transfer, valuations are periodically performed by management and the assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based

**Table of Contents**

on an observable market price or a current appraised value, the Company records the foreclosed asset within Level 2. When an appraised value is not available or management determines that the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset within Level 3 of the fair value hierarchy.

*Goodwill*

See Note 7 for a discussion of the valuation methodologies for goodwill.

**Fair Value of Financial Instruments**

FASB ASC 825, *Financial Instruments*, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis. FASB ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following reflects the fair value of financial instruments, whether or not recognized on the consolidated balance sheet, at fair value (dollars in thousands).

|                               | September 30, 2010 |                      | December 31, 2009 |                      |
|-------------------------------|--------------------|----------------------|-------------------|----------------------|
|                               | Carrying Value     | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| <b>Financial assets:</b>      |                    |                      |                   |                      |
| Cash and cash equivalents     | \$ 27,864          | \$ 27,864            | \$ 32,235         | \$ 32,235            |
| Securities available for sale | 237,088            | 237,088              | 179,440           | 179,440              |
| Securities held to maturity   | 91,765             | 96,540               | 113,165           | 117,008              |
| Equity securities, restricted | 6,990              | 6,990                | 8,346             | 8,346                |
| Loans, non-covered            | 513,156            | 503,390              | 560,460           | 560,781              |
| Loans, covered                | 122,343            | 143,191              | 150,935           | 150,935              |
| FDIC indemnification asset    | 61,170             | 49,948               | 76,107            | 76,107               |
| Accrued interest receivable   | 4,551              | 4,551                | 5,556             | 5,556                |
| <b>Financial liabilities:</b> |                    |                      |                   |                      |
| Noninterest bearing deposits  | 69,494             | 69,494               | 62,198            | 62,198               |
| Interest bearing deposits     | 948,251            | 948,509              | 969,204           | 973,061              |
| Borrowings                    | 41,124             | 45,808               | 50,123            | 53,640               |
| Accrued interest payable      | 1,826              | 1,826                | 2,640             | 2,640                |

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value as of September 30, 2010. The Company applied the provisions of ASC 820 to the fair value measurements of financial instruments not recognized on the consolidated balance sheet at fair value, which include unimpaired non-covered loans, interest receivable, noninterest bearing and interest bearing deposits, other borrowings, and interest payable. The provisions requiring the Company to maximize the use of observable inputs and to measure fair value using a notion of exit price were factored into the Company's selection of inputs into its established valuation techniques.

**Financial Assets***Cash and cash equivalents*

The carrying amounts of cash and due from banks, interest bearing bank deposits, and federal funds sold approximate fair value.

## **Table of Contents**

### ***Securities held to maturity***

For securities held to maturity, fair values are based on quoted market prices or dealer quotes.

### ***Restricted securities***

The carrying value of restricted securities approximates their fair value based on the redemption provisions of the respective issuer.

### ***Loans not covered by FDIC shared loss agreement (non-covered loans)***

For certain homogeneous categories of loans, such as some residential mortgages and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

### ***Loans covered by FDIC shared loss agreement (covered loans)***

Fair values for covered loans are based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, classification status, term of loan and whether or not the loans are amortizing. Loans were pooled together according to similar characteristics and were treated in the aggregate when applying various valuation techniques. The discount rates used for loans are based on the rates used at acquisition (which were based on market rates for new originations of comparable loans) adjusted for any material changes in interest rates since acquisition. Increases in cash flow expectations since acquisition resulted in estimated fair value being higher than carrying value. The increase in cash flows is also reflected in a transfer from unaccretable yield to accretable yield as disclosed in Note 4.

### ***FDIC indemnification asset***

Loss sharing assets are measured separately from the related covered assets as they are not contractually embedded in the covered assets and are not transferable with the assets should the Company choose to dispose of them. Fair value is estimated using projected cash flows related to the obligations under the shared loss agreements based on the expected reimbursements for losses and the applicable loss sharing percentages. These expected reimbursements do not include reimbursable amounts related to future covered expenditures. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. A reduction in loss expectations has resulted in the estimated fair value of the FDIC indemnification asset being lower than its carrying value. This creates a premium that is amortized over the life of the asset and is reflected in Note 5.

### ***Accrued interest receivable***

The carrying amounts of accrued interest receivable approximate fair value.

## **Financial Liabilities**

### ***Noninterest bearing deposits***

The carrying amount approximates fair value.

### ***Interest bearing deposits***

The fair value of NOW accounts, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

**Table of Contents**

*Long-term borrowings*

The fair values of the Company's long-term borrowings, such as FHLB advances, are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

*Accrued interest payable*

The carrying amounts of accrued interest payable approximate fair value.

*Off-balance sheet financial instruments*

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

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

The Company's off-balance sheet commitments are funded at current market rates at the date they are drawn upon. It is management's opinion that the fair value of these commitments would approximate their carrying value, if drawn upon.

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

**Table of Contents****10. EARNINGS PER SHARE**

Basic earnings per share ( EPS ) is computed by dividing net income or loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, including the effect of all potentially dilutive common shares outstanding attributable to stock instruments.

| (dollars and shares in thousands, except per share data) | Income<br>(Numerator) | Weighted<br>Average<br>Shares<br>(Denominator) | Per Common<br>Share<br>Amount |
|--|-----------------------|--|-------------------------------|
| For the three months ended September 30, 2010            |                       |  |                               |
| Basic EPS  | \$ (1,568)            | 21,468   | \$ (0.07)                     |
| Effect of dilutive stock awards                          |                       |  |                               |
| Diluted EPS  | \$ (1,568)            | 21,468   | \$ (0.07)                     |
| For the three months ended September 30, 2009            |                       |  |                               |
| Basic EPS  | \$ (2,172)            | 21,468   | \$ (0.10)                     |
| Effect of dilutive stock awards                          |                       |  |                               |
| Diluted EPS  | \$ (2,172)            | 21,468   | \$ (0.10)                     |
| For the nine months ended September 30, 2010             |                       |  |                               |
| Basic EPS  | \$ (24,487)           | 21,468   | \$ (1.14)                     |
| Effect of dilutive stock awards                          |                       |  |                               |
| Diluted EPS  | \$ (24,487)           | 21,468   | \$ (1.14)                     |
| For the nine months ended September 30, 2009             |                       |  |                               |
| Basic EPS  | \$ (15,920)           | 21,468   | \$ (0.74)                     |
| Effect of dilutive stock awards                          |                       |  |                               |
| Diluted EPS  | \$ (15,920)           | 21,468   | \$ (0.74)                     |

Excluded from the computation of diluted earnings per share were approximately 5.2 million and 7.0 million of awards, options or warrants, during the three and nine months ended September 30, 2010 and 2009, respectively, because their inclusion would be anti-dilutive.

**11. DEFINED BENEFIT PLAN**

The Company adopted the Bank of Essex noncontributory, defined benefit pension plan for all full-time pre-merger Bank of Essex employees over 21 years of age. Benefits are generally based upon years of service and the employees' compensation. The Company funds pension costs in accordance with the funding provisions of the Employee Retirement Income Security Act.

**Components of Net Periodic Benefit Cost**

| Three<br>months | Three<br>months | Nine<br>months | Nine<br>months |
|-----------------|-----------------|----------------|----------------|
|-----------------|-----------------|----------------|----------------|

Edgar Filing: Community Bankers Trust Corp - Form 10-Q

|  | ended                 | ended                 | ended                 | ended                 |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| (In thousands)                               | September 30,<br>2010 | September 30,<br>2009 | September 30,<br>2010 | September 30,<br>2009 |
| Service cost                                 | \$ 92                 | \$ 92                 | \$ 276                | \$ 276                |
| Interest cost                                | 91                    | 81                    | 273                   | 243                   |
| Expected return on plan assets               | (71)                  | (53)                  | (213)                 | (159)                 |
| Amortization of prior service cost           | 1                     | 1                     | 3                     | 3                     |
| Amortization of net obligation at transition | (1)                   | (1)                   | (3)                   | (3)                   |
| Amortization of net loss                     | 15                    | 22                    | 45                    | 66                    |
| Net periodic benefit cost                    | \$ 127                | \$ 142                | \$ 381                | \$ 426                |

## **Table of Contents**

At September 30, 2010, employer contributions totaled \$190,000 for the plan year. The Company is currently analyzing the Defined Benefit Plan as well as other alternatives, such as enhancing its Defined Contribution Plan (401(k)). A determination during fiscal 2010 will be made for the current and future benefits for all full-time employees of the combined entities. The plan was frozen to new entrants prior to BOE's merger with the Company.

## **12. CONTINGENCIES**

See the Quarterly Report on Form 10-Q for the period ended March 31, 2010 for information with respect to transaction-based bonus awards to Gary A. Simanson, who was the Company's Chief Strategic Officer until April 2010. In accordance with GAAP, the Company reflected those bonus awards in the financial statements for the year ended December 31, 2009.

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

The following discussion and analysis of the financial condition at September 30, 2010 and results of operations of Community Bankers Trust Corporation (the Company) for the three and nine months ended September 30, 2010 should be read in conjunction with the Company's consolidated financial statements and the accompanying notes to consolidated financial statements included in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

### ***OVERVIEW***

The Company is a bank holding company that was incorporated under Delaware law on April 6, 2005. The Company is headquartered in Glen Allen, Virginia and is the holding company for Essex Bank (the Bank), a Virginia state bank with 25 full-service offices in Virginia, Maryland and Georgia.

The Bank was established in 1926 and is headquartered in Tappahannock, Virginia. The Bank engages in general commercial banking business and provides a wide range of financial services primarily to individuals and small businesses, including individual and commercial demand and time deposit accounts, commercial and consumer loans, travelers checks, safe deposit box facilities, investment services and fixed rate residential mortgages. Fourteen branches are located in Virginia, primarily from the Chesapeake Bay to just west of Richmond, seven are located in Maryland along the Baltimore-Washington corridor and four are located in the Atlanta, Georgia metropolitan market.

The Company generates a significant amount of its income from the net interest income earned by the Bank. Net interest income is the difference between interest income and interest expense. Interest income depends on the amount of interest-earning assets outstanding during the period and the interest rates earned thereon. The Company's cost of funds is a function of the average amount of interest bearing deposits and borrowed money outstanding during the period and the interest rates paid thereon. The quality of the assets further influences the amount of interest income lost on non-accrual loans and the amount of additions to the allowance for loan losses. Additionally, the Bank earns noninterest income from service charges on deposit accounts and other fee or commission-based services and products. Other sources of non-interest income can include gains or losses on securities transactions, gains from loans sales, transactions involving bank-owned property, and income from Bank Owned Life Insurance (BOLI) policies. The Company's income is offset by non-interest expense, which consists of goodwill impairment and other charges, salaries and benefits, occupancy and equipment costs, professional fees, and other operational expenses. The provision for loan losses and income taxes materially affect income.

### ***CAUTION ABOUT FORWARD-LOOKING STATEMENTS***

The Company makes certain forward-looking statements in this Form 10-Q that are subject to risks and uncertainties. These forward-looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals. These forward-looking statements are generally identified by phrases such as "the Company expects," "the Company believes" or words of similar import.



**Table of Contents**

These forward-looking statements are subject to significant uncertainties because they are based upon or are affected by factors, including, without limitation, the effects of and changes in the following:

the quality or composition of the Company's loan or investment portfolios, including collateral values and the repayment abilities of borrowers and issuers;

assumptions that underlie the Company's allowance for loan losses;

general economic and market conditions, either nationally or in the Company's market areas;

the ability of the Company to comply with regulatory actions, and the costs associated with doing so;

the interest rate environment;

competitive pressures among banks and financial institutions or from companies outside the banking industry;

real estate values;

the demand for deposit, loan, and investment products and other financial services;

the demand, development and acceptance of new products and services;

the Company's compliance with and, the timing of future reimbursements from the FDIC to the Company, under the shared loss agreements;

consumer profiles and spending and savings habits;

the securities and credit markets;

costs associated with the integration of banking and other internal operations;

management's evaluation of goodwill and other assets on a periodic basis, and any resulting impairment charges, under applicable accounting standards;

## Edgar Filing: Community Bankers Trust Corp - Form 10-Q

the soundness of other financial institutions with which the Company does business;

inflation;

technology; and

legislative and regulatory requirements.

These factors and additional risks and uncertainties are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 and other reports filed from time to time by the Company with the Securities and Exchange Commission.

Although the Company believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

## **Table of Contents**

### ***CRITICAL ACCOUNTING POLICIES***

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

The following is a summary of the Company's critical accounting policies that are highly dependent on estimates, assumptions and judgments.

#### ***Allowance for Loan Losses on Non-covered Loans***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is an amount that management believes is appropriate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio, based on an evaluation of the collectability of existing loans and prior loss experience. This quarterly evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. For loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, management believes that it is more likely than not that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, availability of current financial information, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment

## **Table of Contents**

delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

### ***Allowance for Loan Losses on Covered Loans***

The covered loans are subject to credit review standards described above for non-covered loans. If and when credit deterioration occurs subsequent to the date that the covered loans were acquired, a provision for credit loss for covered loans will be charged to earnings for the full amount without regard to the FDIC shared loss agreements. The Company makes an estimate of the total cash flows it expects to collect from a pool of covered loans, which includes undiscounted expected principal and interest. Over the life of the loan or pool, the Company continues to estimate cash flows expected to be collected. Subsequent decreases in cash flows expected to be collected over the life of the pool are recognized as impairments in the current period through allowance for loan losses. Subsequent increases in expected cash flows are first used to reverse any existing valuation allowance for that loan or pool. Any remaining increase in cash flows expected to be collected is recognized as an adjustment to the yield over the remaining life of the pool.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential covered loans for impairment disclosures.

### ***Accounting for Certain Loans or Debt Securities Acquired in a Transfer***

FASB ASC 310, *Receivables*, requires acquired loans to be recorded at fair value and prohibits carrying over valuation allowances in the initial accounting for acquired impaired loans. Loans carried at fair value, mortgage loans held for sale, and loans to borrowers in good standing under revolving credit arrangements are excluded from the scope of ASC 310, which limits the yield that may be accreted to the excess of the undiscounted expected cash flows over the investor's initial investment in the loan. The excess of the contractual cash flows over expected cash flows may not be recognized as an adjustment of yield. Subsequent increases in cash flows to be collected are recognized prospectively through an adjustment of the loan's yield over its remaining life. Decreases in expected cash flows are recognized as impairments through the allowance for loan losses.

In the Company's acquisition of TFC and BOE, the fair value of ASC 310 loans was determined based on assigned risk ratings, expected cash flows and the fair value of the collateral. The fair value of non ASC 310 loans was determined based on preliminary estimates of default probabilities. The Company determined which purchased loans were impaired at the time of the acquisition and considered those loans for ASC 310 application. Those loans that were not considered impaired at the time of acquisition were not considered for ASC 310.

As a result of the acquisitions of TFC and BOE, the Company had loans of \$5.0 million at December 31, 2008 that met the criteria of ASC 310. Due to the immateriality of these loans in relation to the overall financial condition of the Company, detailed disclosures have not been included in the financial statements.

The covered loans from the SFSB transaction, subject to FASB ASC Topic 805, *Business Combinations*, were recorded at fair value and no separate valuation allowance was recorded at the date of acquisition. FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, applies to loans acquired in a transfer with evidence of deterioration of credit quality for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. The Company is applying the provisions of ASC 310-30 to all loans acquired in the SFSB transaction. The Company has grouped loans together based on common risk characteristics including product type, delinquency status and loan documentation requirements among others.

---

**Table of Contents**

The Company has made an estimate of the total cash flows it expects to collect from a pool of loans, which includes undiscounted expected principal and interest. The excess of that amount over the fair value of the pool is referred to as accretable yield. Accretable yield is recognized as interest income on a constant yield basis over the life of the pool. The Company also determines each pool's contractual principal and contractual interest payments. The excess of that amount over the total cash flows that it expects to collect from the pool is referred to as nonaccretable difference, which is not accreted into income. Judgmental prepayment assumptions are applied to both contractually required payments and cash flows expected to be collected at acquisition. Over the life of the loan or pool, the Company continues to estimate cash flows expected to be collected. Subsequent decreases in cash flows expected to be collected over the life of the pool are recognized as an impairment in the current period through the allowance for loan losses. Subsequent increases in expected or actual cash flows are first used to reverse any existing valuation allowance for that loan or pool. Any remaining increase in cash flows expected to be collected is recognized as an adjustment to the accretable yield with the amount of periodic accretion adjusted over the remaining life of the pool.

***FDIC Indemnification Asset***

The Company is accounting for the shared loss agreements as an indemnification asset pursuant to the guidance in FASB ASC 805. The FDIC indemnification asset is required to be measured in the same manner as the asset or liability to which it relates. The FDIC indemnification asset is measured separately from the covered loans and other real estate owned assets because it is not contractually embedded in the covered loan and other real estate owned assets and is not transferable should the Company choose to dispose of them. Fair value was estimated using projected cash flows available for loss sharing based on the credit adjustments estimated for each loan pool and other real estate owned and the loss sharing percentages outlined in the purchase and assumption agreements with the FDIC. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC.

Because the acquired loans are subject to shared loss agreements and a corresponding indemnification asset exists to represent the value of expected payments from the FDIC, increases and decreases in loan accretable yield due to changing loss expectations will also have an impact to the valuation of the FDIC indemnification asset. Improvement in loss expectations will typically increase loan accretable yield and decrease the value of the FDIC indemnification asset and, in some instances, result in an amortizable premium on the FDIC indemnification asset. Increases in loss expectations will typically be recognized as impairment in the current period through allowance for loan losses while resulting in additional non-interest income for the amount of the increase in the FDIC indemnification asset.

***Goodwill and Other Intangible Assets***

FASB ASC 805, *Business Combinations*, requires that the purchase method of accounting be used for all business combinations after June 30, 2001. With purchase acquisitions, the Company is required to record assets acquired, including any intangible assets, and liabilities assumed at fair value, which involves relying on estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analysis or other valuation methods. The Company records goodwill per ASC 350, *Intangibles-Goodwill and Others*. Accordingly, goodwill is no longer subject to amortization over its estimated useful life, but is subject to at least an annual assessment for impairment by applying a fair value-based test. Additionally, under ASC 350, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful lives. ASC 350 discontinues any amortization of goodwill and other intangible assets with indefinite lives, but requires an impairment review at least annually or more often if certain conditions exist. The Company followed ASC 350 and determined that any core deposit intangibles will be amortized over the estimated useful life.

---

**Table of Contents**
***Income Taxes***

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. A valuation allowance is provided when it is more likely than not that some portion of a deferred tax asset will not be realized.

Included in deferred tax assets are the tax benefits derived from net operating loss carryforwards totaling \$2.4 million, relating to the TFC acquisition, which expire in various amounts from 2021 through 2024. In management's opinion, it is more likely than not that the results of future operations will generate sufficient taxable income to recognize the deferred tax assets. Therefore, no allowance is required.

***Other Real Estate Owned***

Real estate acquired through, or in lieu of, loan foreclosure is held for sale and is initially recorded at the lower of the loan balance or the fair value at the date of foreclosure net of estimated disposal costs, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or the fair value less costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses. Costs to bring a property to salable condition are capitalized up to the fair value of the property while costs to maintain a property in salable condition are expensed as incurred.

***RESULTS OF OPERATIONS***

Net loss available to common stockholders was \$1.6 million, or \$0.07 per common share on a diluted basis, for the quarter ended September 30, 2010 compared with a net loss of \$2.2 million, or \$0.10 per common share on a diluted basis, for the quarter ended September 30, 2009. The reduced loss for the quarter was primarily driven by a reduction in the provision for loan losses of \$4.1 million from \$5.2 million in the third quarter of 2009 to \$1.1 million for the third quarter of 2010. The decrease was offset by a \$3.7 million decrease in noninterest income reflecting increased securities and other real estate losses as well as better than expected losses in the covered loan portfolio resulting in \$1.3 million of the reduction of the FDIC indemnification asset during the quarter ended September 2010.

For the nine months ended September 30, 2010, net loss available to common stockholders was \$24.5 million, compared with net loss available to common stockholders of \$15.9 million for the same period in 2009. These losses represented \$1.14 per share on a fully diluted basis, versus \$0.74 for the first nine months of 2009. Losses for the nine months ended September 30, 2010 were primarily driven by two factors: \$27.4 million in loan loss provisions and an impairment charge for the remaining \$5.7 million of non-tax deductible goodwill in the second quarter of 2010. Economic conditions, evidenced by the significant loan loss provision taken this year, warranted an impairment evaluation of goodwill prior to the annual evaluation date of December 31, 2010. The losses evidenced in the first nine months of 2009 were the result of the \$24.0 million goodwill impairment charge which was partially offset by a one-time pre-tax gain of \$20.3 million related to the SFSB transaction in the first quarter of the year.

***Net Interest Income***

The Company's operating results depend primarily on its net interest income, which is the difference between interest income on interest-earning assets, including securities and loans, and interest expense incurred on interest bearing liabilities, including deposits and other borrowed funds. Net interest income is affected by changes in the amount and mix of interest-earning assets and interest bearing liabilities, referred to as a volume change. It is also affected by changes in yields earned on interest-earning assets and rates paid on interest bearing deposits and other borrowed funds, referred to as a rate change.

Net interest income on a tax equivalent basis was \$11.1 million for the quarter ended September 30, 2010, compared to \$10.6 million for the quarter ended June 30, 2010. This represents an increase of 5.2%. Net interest income on a tax equivalent basis increased \$2.5 million, or 8.3%, for the first nine months of 2010 versus the same period in 2009. Loan interest income was adversely affected by declining loan balances as well as an increase in nonperforming loans throughout the second half of 2009 and the first nine months of 2010. However, an aggressive deposit pricing strategy with respect to all deposit categories offset the decline in loan income, which resulted in the increase in net interest income. Interest expense on deposits equalled \$4.1 million for the three months ended September 30, 2010, which represented a \$345,000, or 7.7%, improvement from the quarter ended June 30, 2010 as well as a \$1.9 million, or 31.3%, improvement from the quarter ended September 30, 2009. Interest expense totalled \$14.5 million for the nine months ended September 30, 2010 compared with \$19.5 million for the same period in

2009, a \$5.0 million, or 25.8%, improvement.

**Table of Contents**

The net interest margin on a tax equivalent basis for the quarter ended September 30, 2010 increased 26 basis points to 4.30% compared with 4.04% for the quarter ended June 30, 2010. The net interest margin on a tax equivalent basis for the quarter ended September 30, 2010 increased 52 basis points from 3.78% for the quarter ended September 30, 2009. The primary component influencing net interest income, as well as the net interest margin, was a lower overall interest expense relative to the deposit base. Management proactively lowered rates on virtually all deposits during 2009 and 2010 in an effort to enhance earnings. This resulted in a 12 basis point, or 6.6%, decline in the cost of deposits on a linked quarter basis and a 74 basis point decline from the quarter ended September 30, 2010. The most significant influence on the cost of funds for the Bank was the repricing of the time deposit base during the same period. The average cost of time deposits declined 14 basis points, from 2.32% for the quarter ended June 30, 2010, to 2.18% for the quarter ended September 30, 2010. The average cost of time deposits was 2.18% for the quarter ended September 30, 2010, an 88 basis points decline from 3.06% for the quarter ended September 30, 2009. This improvement was the direct result of prudent deposit pricing in all regions, while not compromising the Bank's liquidity.

An additional benefit to the net interest margin was the improved yield on FDIC covered loans. On a linked quarter basis, the yield on covered loans equaled 11.65% for the quarter ended September 30, 2010, an improvement of 189 basis points from the quarter ended June 30, 2010 and 200 basis points from the third quarter of 2009. This is primarily the result of better than expected performance on these loans since the forecast at the acquisition date. FDIC covered loans are held on the balance sheet at carrying value.

For the first nine months of 2010, the net interest margin on a tax equivalent basis increased 48 basis points to 4.12% compared with 3.64% for the same period in 2009. As noted above, the primary component influencing net interest income, as well as the net interest margin, was a lower overall interest expense relative to the deposit base. The cost of deposits declined 66 basis points from 2.50% to 1.84% over these respective periods.

An additional benefit to the net interest margin for the first nine months of 2010 again was the improved yield on FDIC covered loans. The yield on these loans improved 103 basis points from 9.34% for the first nine months of 2009 to 10.37% for the same period in 2010.

The following tables set forth, for each category of interest-earning assets and interest bearing liabilities, the average amounts outstanding, the interest earned or paid on such amounts, and the average rate earned or paid for the quarters ended and nine months ended September 30, 2010 and 2009. The tables also set forth the average rate paid on total interest bearing liabilities, and the net interest margin on average total interest-earning assets for the same periods. Except as indicated in the footnotes, no tax equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table as loans carrying a zero yield.



**Table of Contents****COMMUNITY BANKERS TRUST CORPORATION****NET INTEREST MARGIN ANALYSIS****AVERAGE BALANCE SHEETS**

| (dollars in thousands)                     | Three months ended September 30, 2010 |                                |                                 | Three months ended September 30, 2009 |                                |                                 |
|--|---------------------------------------|--------------------------------|---------------------------------|---------------------------------------|--------------------------------|---------------------------------|
|  | Average<br>Balance<br>Sheet           | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/Paid | Average<br>Balance<br>Sheet           | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/Paid |
| <b>ASSETS:</b>                             |                                       |                                |                                 |                                       |                                |                                 |
| Loans non covered, including fees          | \$ 557,324                            | \$ 8,235                       | 5.91%                           | \$ 559,547                            | \$ 8,820                       | 6.31%                           |
| FDIC covered loans, including fees         | 126,818                               | 3,692                          | 11.65                           | 172,050                               | 4,152                          | 9.65                            |
| Total loans                                | 684,142                               | 11,927                         | 6.97                            | 731,597                               | 12,972                         | 7.09                            |
| Interest bearing bank balances             | 15,748                                | 19                             | 0.48                            | 11,061                                | 60                             | 2.17                            |
| Federal funds sold                         | 3,814                                 | 1                              | 0.08                            | 20,905                                | 10                             | 0.19                            |
| Securities (taxable)                       | 239,766                               | 2,340                          | 3.90                            | 216,277                               | 2,081                          | 3.85                            |
| Securities (tax exempt) <sup>(1)</sup>     | 90,819                                | 1,310                          | 5.77                            | 91,927                                | 1,358                          | 5.91                            |
| Total earning assets                       | 1,034,289                             | 15,597                         | 6.03                            | 1,071,767                             | 16,481                         | 6.15                            |
| Allowance for loan losses                  | (39,044)                              |                                |                                 | (13,290)                              |                                |                                 |
| Non-earning assets                         | 197,548                               |                                |                                 | 193,267                               |                                |                                 |
| Total assets                               | \$ 1,192,793                          |                                |                                 | \$ 1,251,744                          |                                |                                 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                                       |                                |                                 |                                       |                                |                                 |
| Demand - interest bearing                  | \$ 233,102                            | \$ 385                         | 0.66                            | \$ 200,965                            | \$ 381                         | 0.76                            |
| Savings                                    | 63,400                                | 91                             | 0.57                            | 58,438                                | 100                            | 0.68                            |
| Time deposits                              | 674,080                               | 3,665                          | 2.18                            | 724,191                               | 5,545                          | 3.06                            |
| Total deposits                             | 970,582                               | 4,141                          | 1.71                            | 983,594                               | 6,026                          | 2.45                            |
| Federal funds purchased                    | 49                                    | 1                              | 0.60                            | 1,126                                 | 2                              | 0.71                            |
| FHLB and other borrowings                  | 41,124                                | 342                            | 3.32                            | 40,005                                | 338                            | 3.38                            |
| Total interest bearing liabilities         | 1,011,755                             | 4,484                          | 1.77                            | 1,024,725                             | 6,366                          | 2.48                            |
| Noninterest bearing deposits               | 63,422                                |                                |                                 | 61,269                                |                                |                                 |
| Other liabilities                          | 7,622                                 |                                |                                 | 19,000                                |                                |                                 |
| Total liabilities                          | 1,082,799                             |                                |                                 | 1,104,994                             |                                |                                 |
| Stockholders equity                        | 109,994                               |                                |                                 | 146,750                               |                                |                                 |
| Total liabilities and stockholders equity  | \$ 1,192,793                          |                                |                                 | \$ 1,251,744                          |                                |                                 |
| Net interest earnings                      |                                       | \$ 11,113                      |                                 |                                       | \$ 10,115                      |                                 |
| Net interest spread                        |                                       |                                | 4.26%                           |                                       |                                | 3.67%                           |
| Net interest margin                        |                                       |                                | 4.30%                           |                                       |                                | 3.78%                           |

- (1) Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

**Table of Contents****COMMUNITY BANKERS TRUST CORPORATION****NET INTEREST MARGIN ANALYSIS****AVERAGE BALANCE SHEETS**

| (dollars in thousands)                     | Nine months ended September 30, 2010 |                                |                                 | Nine months ended September 30, 2009 |                                |                                 |
|--|--------------------------------------|--------------------------------|---------------------------------|--------------------------------------|--------------------------------|---------------------------------|
|  | Average<br>Balance<br>Sheet          | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/Paid | Average<br>Balance<br>Sheet          | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/Paid |
| <b>ASSETS:</b>                             |                                      |                                |                                 |                                      |                                |                                 |
| Loans non covered, including fees          | \$ 570,090                           | \$ 25,436                      | 5.95%                           | \$ 547,578                           | \$ 26,236                      | 6.39%                           |
| FDIC covered loans, including fees         | 137,246                              | 10,671                         | 10.37                           | 162,476                              | 11,380                         | 9.34                            |
| Total loans                                | 707,336                              | 36,107                         | 6.81                            | 710,054                              | 37,616                         | 7.06                            |
| Interest bearing bank balances             | 18,527                               | 73                             | 0.53                            | 23,332                               | 262                            | 1.50                            |
| Federal funds sold                         | 4,018                                | 5                              | 0.18                            | 20,914                               | 36                             | 0.23                            |
| Securities (taxable)                       | 219,602                              | 6,507                          | 3.95                            | 250,738                              | 7,580                          | 4.03                            |
| Securities (tax exempt) <sup>(1)</sup>     | 91,454                               | 3,999                          | 5.83                            | 84,255                               | 3,747                          | 5.93                            |
| Total earning assets                       | 1,040,937                            | 46,691                         | 5.98                            | 1,089,293                            | 49,241                         | 6.03                            |
| Allowance for loan losses                  | (27,091)                             |                                |                                 | (10,484)                             |                                |                                 |
| Non-earning assets                         | 199,365                              |                                |                                 | 194,924                              |                                |                                 |
| Total assets                               | \$ 1,213,211                         |                                |                                 | \$ 1,273,733                         |                                |                                 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                                      |                                |                                 |                                      |                                |                                 |
| Demand - interest bearing                  | \$ 224,204                           | \$ 1,178                       | 0.70                            | \$ 193,998                           | \$ 1,556                       | 1.07                            |
| Savings                                    | 62,053                               | 271                            | 0.58                            | 54,733                               | 374                            | 0.91                            |
| Time deposits                              | 690,223                              | 12,036                         | 2.32                            | 734,653                              | 16,513                         | 3.00                            |
| Total deposits                             | 976,480                              | 13,485                         | 1.84                            | 983,384                              | 18,443                         | 2.50                            |
| Federal funds purchased                    | 229                                  | 1                              | 0.60                            | 1,085                                | 6                              | 0.74                            |
| FHLB and other borrowings                  | 41,124                               | 1,006                          | 3.26                            | 43,415                               | 1,071                          | 3.29                            |
| Total interest bearing liabilities         | 1,017,833                            | 14,492                         | 1.90                            | 1,027,884                            | 19,520                         | 2.53                            |
| Noninterest bearing deposits               | 62,756                               |                                |                                 | 61,313                               |                                |                                 |
| Other liabilities                          | 9,276                                |                                |                                 | 26,041                               |                                |                                 |
| Total liabilities                          | 1,089,865                            |                                |                                 | 1,115,238                            |                                |                                 |
| Stockholders equity                        | 123,346                              |                                |                                 | 158,495                              |                                |                                 |
| Total liabilities and stockholders equity  | \$ 1,213,211                         |                                |                                 | \$ 1,273,733                         |                                |                                 |
| Net interest earnings                      |                                      | \$ 32,199                      |                                 |                                      | \$ 29,721                      |                                 |
| Net interest spread                        |                                      |                                | 4.08%                           |                                      |                                | 3.50%                           |
| Net interest margin                        |                                      |                                | 4.12%                           |                                      |                                | 3.64%                           |

- (1) Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

---

**Table of Contents**

***Provision for Loan Losses***

Management actively monitors the Company's asset quality and provides specific loss provisions when necessary. Provisions for loan losses are charged to income to bring the total allowance for loan losses to a level deemed appropriate by management of the Company based on such factors as historical credit loss experience, industry diversification of the commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume growth and composition of the loan portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the loan portfolio through the internal loan review function and other relevant factors. See *Allowance for Loan Losses on Non-covered loans* in the Critical Accounting Policies section above for further discussion.

Loans are charged-off against the allowance for loan losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for loan losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations.

Management also actively monitors its covered loan portfolio for impairment and necessary loan loss provisions. Provisions for covered loans may be necessary due to a change in expected cash flows or an increase in expected losses within a pool of loans.

The Company incurred \$1.1 million in provision for loan losses for non-covered loans for the quarter ended September 30, 2010 and a \$5.2 million provision for the quarter ended September 30, 2009. The ratio of the allowance for loan losses to nonperforming non-covered loans was 79.3% at September 30, 2010 compared with 89.7% at December 31, 2009. The ratio of allowance for loan losses to total non-covered loans was 6.27% at September 30, 2010 compared with 3.14% at December 31, 2009. For the quarter ended September 30, 2010, net charge-offs were \$5.6 million compared with net charge-offs of \$1.2 million for the quarter ended September 30, 2009.

The provision for loan losses for non-covered loans totalled \$26.6 million for the nine months ended September 30, 2010 versus \$11.3 million for the same period in 2009. Through the first nine months of 2010, the Company had net charge-offs on non-covered loans of \$10.4 million versus \$2.0 million for the same period in 2009.

For the nine months ending September 30, 2010, a provision for loan losses on the covered loan portfolio of \$880,000 established an allowance for covered loan losses of the same amount. This provision was due solely to timing differences in expected cash flows, not an increase in expected losses. This provision occurred in the second quarter of 2010.

While the covered loan portfolio contains significant risk, it was considered in determining the initial fair value, which was reflected as the carrying value recorded at the time of the SFSB transaction, less the FDIC guaranteed portion of losses on covered assets.

***Noninterest Income***

On a linked quarter basis, noninterest income was negative \$1.5 million, in the third quarter of 2010, compared with negative \$115,000 for the second quarter of 2010. Noninterest income was \$2.1 million in the third quarter of 2009. The decline in noninterest income was due to lower than expected losses in the covered loan portfolio, which resulted in a reduction of the FDIC indemnification asset of \$1.3 million during the quarter. This reduction is offset by increased loan yield on covered loans evidenced in the net interest margin calculation. Other noninterest income for the third quarter of 2010 included losses on sales of securities of \$296,000 versus losses of \$452,000 for the second quarter of 2010 and gains of \$612,000 for the third quarter of 2009. Lastly, the Company had losses due to fair market value adjustments on non-covered other real estate of \$514,000 during the third quarter of 2010.

The Company's primary source of core noninterest income are service charges on deposit accounts, which include insufficient funds charges, check cashing fees, official check fees, and safe deposit box rentals. On a linked

---

**Table of Contents**

quarter basis, service charges on deposit accounts were \$659,000 for the quarter ended September 30, 2010 compared with \$622,000 for the quarter ended June 30, 2010. Service charges on deposit accounts were \$674,000 in the third quarter of 2009.

For the nine months ended September 30, 2010, noninterest income was negative \$1.2 million compared with positive \$24.9 million for the first nine months of 2009. The magnitude of the \$26.1 million change year over year was due to the one-time \$20.3 million pre-tax gain related to the acquisition of SFSB in 2009. Excluding the one-time gain in 2009, noninterest income would have been \$4.7 million for the first three quarters, which would have resulted in a decline in noninterest income of \$5.9 million when comparing the nine month periods.

Other noninterest income for the first nine months of 2010 included net write-downs and losses of \$772,000 on covered other real estate in the FDIC acquired SFSB portfolio, comprised of \$3.9 million of write-downs and sales offset by \$3.1 million due from the FDIC. The net amount reflects the Company's 20% loss portion under the shared loss agreements with the FDIC.

In addition, lower than expected losses in the covered loan portfolio resulted in a reduction of the FDIC indemnification asset of \$2.0 million during the first nine months of 2010. These losses are partially offset by increased loan yield on covered loans presented in the net interest margin calculation. Service charges on deposit accounts were \$1.9 million for the first nine months of 2010 and remained virtually unchanged from the same period in 2009. Securities losses totaled \$394,000 for the first nine months of 2010 compared with \$905,000 in gains for the first nine months of 2009. The losses reflect the other than temporary impairment (OTTI) charge taken on financial institution securities held at the parent level. The Company determined that it did not have the intent to hold these securities for a sufficient amount of time to allow them to recover their value. The Bank's securities portfolio continues to have no other than temporary impairments.

***Noninterest Expense***

Noninterest expenses totalled \$10.4 million for the three months ended September 30, 2010 compared with \$10.5 million for the three months ended June 30, 2010, excluding impairment of goodwill of \$5.7 million in the second quarter of 2010, or a decrease of \$61,000. Noninterest expenses for the quarter ended September 30, 2010 increased \$500,000, or 4.5%, to \$10.4 million compared with \$9.9 million for the quarter ended September 30, 2009.

Salaries and employee benefits were \$5.3 million, or 50.6% of all noninterest expenses for the quarter ended September 30, 2010, compared with \$4.8 million, or 46.0% of all noninterest expenses for the quarter ended June 30, 2010, excluding the impairment of goodwill. Salaries and wages for the quarter ended September 30, 2010 increased \$415,000, or 8.6%, from the same quarter in 2009.

Occupancy expenses equaled \$774,000 for the three months ended September 30, 2010 versus \$713,000 for the three months ended June 30, 2010, an increase of \$61,000, or 8.6%. Occupancy expenses increased \$22,000, or 2.9% for the three months ended September 30, 2010 compared to \$752,000 for the third quarter of 2009.

Equipment expenses equaled \$322,000 for the three months ended September 30, 2010 versus \$363,000 for the three months ended June 30, 2010, a decrease of \$41,000, or 11.3%. Equipment expenses decreased \$114,000, or 26.1% for the three months ended September 30, 2010 compared to \$436,000 for the third quarter of 2009.

FDIC deposit insurance expense was \$579,000 for the three months ended September 30, 2010 compared with \$613,000 for the quarter ended June 30, 2010, a decline of 5.6%. FDIC deposit insurance expenses aggregated \$436,000 for the third quarter of 2009. Increased FDIC expenses during the first and second quarters of 2010 represent the amortization of the \$8.7 million payment made at year end 2009, which is expensed over three years in amounts prescribed by the FDIC.

Other noninterest expenses include professional fees of \$425,000 for the three months ended September 30, 2010 compared to \$743,000 for the three months ended June 30, 2010, a decrease of \$318,000, or 42.8%. Professional fees increased \$240,000 for the quarter ended September 30, 2010 versus the quarter ended September 30, 2009 due solely to contracted labor for internal audit, external loan review, and additional labor to implement the accounting for loans managed under the FDIC shared loss agreements. Management anticipates lower professional fees in future quarters.

---

**Table of Contents**

Legal fees for the three months ended September 30, 2010 were \$117,000 compared to \$96,000 for the three months ended June 30, 2010, a \$21,000 increase, or 21.9%. However, legal fees declined \$100,000 for the third quarter of 2010 versus the quarter ended September 2009 due to legal work necessitated by the SFSB transaction.

Other noninterest expenses for the three months ended September 30, 2010 included other operating expenses of \$1.6 million and amortization of intangibles of \$565,000. Other operating expenses decreased by \$362,000 from the quarter ended June 30, 2010 and \$150,000 from the quarter ended September 30, 2009.

For the nine months ended September 30, 2010, noninterest expenses aggregated \$36.4 million, a decline of \$17.4 million, or 32.4%, compared with \$53.8 million for the same period in 2009. Excluding goodwill impairment charges, noninterest expenses would have totaled \$30.7 million for the first nine months of 2010 versus \$29.8 million for the first nine months of 2009.

Salaries and employee benefits were \$15.2 million and represented 49.5% of all noninterest expenses excluding the goodwill impairment charge, for the first nine months of the year. Salaries and employee benefits increased \$897,000, or 6.3%, from the same period in 2009. Occupancy expenses were \$2.2 million for the nine months ended September 30, 2010 compared with \$1.9 million for the same period in 2009. The \$340,000, or 18.0%, increase in occupancy expenses noted above is the direct result of having a full nine months of expense related to the acquisition of bank premises in May 2009 associated with the SFSB transaction. Equipment expenses were \$1.1 million through September 30, 2010 versus \$1.2 million for the first nine months of 2009, a decrease of \$101,000.

FDIC deposit insurance expenses totaled \$1.8 million for the first nine months of 2010 compared with \$1.3 million for the same period in 2009. The FDIC expenses taken during 2010 represent the amortization of the \$8.7 million pre-payment from year end 2009, which include all of the SFSB deposits.

Professional fees were \$1.5 million for the first three quarters of 2010 compared with \$1.3 million for the same period in 2009. Professional fees increased by \$161,000, or 12.0%, for the first nine months of 2010 versus the same period of 2009. Professional fees were high for both periods due to increased contract labor in 2010, and 2009 professional fees reflected one time fees related to the SFSB transaction. Legal fees declined \$513,000, or 66.5%, from \$772,000 in the first nine months of 2009 to \$259,000 for the same period of 2010. Again, the Bank incurred higher legal costs in the first nine months of 2009 related to the SFSB transaction.

Data processing fees declined \$404,000, or 18.2%, from \$2.2 million for the nine months ended September 30, 2009 to \$1.8 million for the same period in 2010. The decline is attributable to the full integration of the SFSB platform in 2009.

Other noninterest expenses for the nine months ended September 30, 2010 included other operating expenses of \$5.1 million and amortization of intangibles of \$1.2 million, which were consistent with the same period in 2009.

***Income Taxes***

Income tax benefit was \$1.1 million for the three months ended September 30, 2010, compared with income tax benefit of \$1.5 million for the same period in 2009.

The Company recorded an income tax benefit of \$10.6 million for the first nine months of 2010 versus income tax expense of \$3.4 million for the first nine months of 2009. Despite reporting a pre-tax loss of \$11.7 million for the first nine months of 2009, the Company incurred an income tax expense of \$3.4 million due to the gain recorded on the SFSB transaction and the non-deductible nature of goodwill impairment charges.

---

**Table of Contents**

***FINANCIAL CONDITION***

At September 30, 2010, the Company had total assets of \$1.178 billion, a decrease of \$48.9 million, or 4.0%, from \$1.227 billion at December 31, 2009. Total loans, including loans covered by the FDIC shared loss agreements of \$123.0 million, aggregated \$670.7 million at September 30, 2010 decreasing \$58.9 million, or 8.1%, from \$729.6 million at December 31, 2009. The carrying value of covered loans declined \$28.8 million, or 18.4%, from December 31, 2009. The reduction in the covered loan portfolio was due to the work of the Company's special assets department in handling the disposition of FDIC covered assets and declining balances of FDIC covered loans. Non-covered loans equaled \$547.5 million at September 30, 2010, declining \$31.1 million, or 5.4%, since year end. The decline in loan volume within the non-covered loan portfolio was the direct result of \$10.4 million in net loan charge-offs coupled with loan run-off and an overall decrease in loan demand.

The Company's securities portfolio increased \$34.9 million, or 11.6%, during the first three quarters of 2010 to equal \$335.8 million. The Company had Federal funds sold of \$2.9 million at September 30, 2010 versus none at year-end 2009. The increase in the securities portfolio and overnight funds was due to the decline in total loans noted above, as excess deposit balances were invested accordingly.

The Company is required to account for the effect of market changes in the value of securities available-for-sale (AFS) under FASB ASC 320, *Investments - Debt and Equity Securities*. The market value of the AFS portfolio was \$237.1 million at September 30, 2010 and \$179.4 million at December 31, 2009. At September 30, 2010, the Company had a net unrealized gain on the AFS portfolio of \$10.2 million compared with a net unrealized gain of \$3.1 million at December 31, 2009.

In October 2010, the Bank sold \$71.6 million in AFS securities. These transactions had several strategic components. First, the Company is attempting to de-leverage its balance sheet to increase its Tier 1 leverage capital ratio. Second, the sales shorten the duration of the Company's asset base and make it less vulnerable to an increase in interest rates. Third, the sales resulted in a gain of \$3.4 million, which is immediately accretive, net of tax, and will enhance the Bank's capital ratios. All of these transactions will settle and be reported in the fourth quarter of 2010. There is no assurance that this net gain will be fully realized during the fourth quarter of 2010, as the Company may engage in transactions, for liquidity purposes or otherwise, that result in securities losses.

Total deposits at September 30, 2010 were \$1.018 billion, decreasing \$13.7 million from December 31, 2009, time deposits declined \$42.5 million during the first nine months of 2010 as management continued to lower rates among all regions as loan demand was weak and covered loans continued to decline in volume. The most notable increase by deposit category was evidenced in money market deposit accounts, which increased \$14.8 million, or 13.1%, during the first nine months of 2010. Other accounts such as NOW, savings, and demand deposits collectively increased \$6.7 million or 4.4%. The Company's total loan-to-deposit ratio was 65.9% at September 30, 2010 and 70.7% at December 31, 2009.

The Company had Federal Home Loan Bank (FHLB) advances of \$37.0 million at each of September 30, 2010 and December 31, 2009.

Stockholders' equity at September 30, 2010 was \$110.7 million and represented 9.4% of total assets. Stockholders' equity was \$131.6 million, or 10.7% of total assets, at December 31, 2009. Stockholders' equity was impacted by the net operating loss and write-off of remaining goodwill. The reduction in goodwill did not impact tangible equity or regulatory capital ratios.



**Table of Contents***Asset Quality non-covered assets*

The allowance for loan losses represents management's estimate of the amount appropriate to provide for probable losses inherent in the loan portfolio.

Non-covered loan quality is continually monitored, and the Company's management has established an allowance for loan losses that it believes is appropriate for the risks inherent in the loan portfolio. Among other factors, management considers the Company's historical loss experience, the size and composition of the loan portfolio, the value and appropriateness of collateral and guarantors, non-performing credits and current and anticipated economic conditions. There are additional risks of future loan losses, which cannot be precisely quantified nor attributed to particular loans or classes of loans. Because those risks include general economic trends, as well as conditions affecting individual borrowers, the allowance for loan losses is an estimate. The allowance is also subject to regulatory examinations and determination as to appropriateness, which may take into account such factors as the methodology used to calculate the allowance and size of the allowance in comparison to peer companies identified by regulatory agencies. See *Allowance for Loan Losses on Non-covered loans* in the Critical Accounting Policies section above for further discussion.

The Company maintains a list of non-covered loans that have potential weaknesses and thus may need special attention. This nonperforming loan list is used to monitor such loans and is used in the determination of the appropriateness of the allowance for loan losses. At September 30, 2010, non-covered nonperforming assets totaled \$47.7 million and net charge-offs were \$10.4 million for the nine month period then ended. This compares with nonperforming assets of \$21.8 million and net charge-offs of \$7.9 million at and for the year ended December 31, 2009. Nonperforming loans increased \$25.8 million during the first nine months of 2010.

The following table sets forth selected asset quality data, excluding FDIC covered assets, and ratios for the dates indicated:

| (dollars in thousands)                                   | September 30, 2010 | December 31, 2009 |
|--|--------------------|-------------------|
| Nonaccrual loans   | \$ 43,298          | \$ 20,011         |
| Loans past due over 90 days and accruing interest        | 35                 | 247               |
| <b>Total nonperforming non-covered loans</b>             | <b>43,333</b>      | <b>20,258</b>     |
| Other real estate owned (OREO) non-covered               | 4,320              | 1,586             |
| <b>Total nonperforming non-covered assets</b>            | <b>\$ 47,653</b>   | <b>\$ 21,844</b>  |
| Accruing troubled debt restructure loans                 | \$ 1,375           |                   |
| <b>Balances</b>  |                    |                   |
| Allowance for loan losses                                | \$ 34,353          | \$ 18,169         |
| Average loans during quarter, net of unearned income     | 557,324            | 573,367           |
| Loans, net of unearned income                            | 547,509            | 578,629           |
| <b>Ratios</b>  |                    |                   |
| Allowance for loan losses to loans                       | 6.27%              | 3.14%             |
| Allowance for loan losses to nonperforming assets        | 72.09%             | 83.18%            |
| Allowance for loan losses to nonaccrual loans            | 79.34%             | 90.80%            |
| Nonperforming assets to loans and other real estate      | 8.64%              | 3.77%             |
| Net charge-offs for quarter to average loans, annualized | 3.98%              | 4.09%             |

The Company performs troubled debt restructures and other various loan workouts whereby an existing loan may be restructured into multiple new loans. At September 30, 2010, the Company had four loans that met the

**Table of Contents**

definition of a troubled debt restructure ( TDR ), which are loans that for reasons related to the debtor s financial difficulties have been restructured on terms and conditions that would otherwise not be offered or granted. One of these loans was restructured using multiple new loans. The aggregated outstanding principal at that date of these loans was \$4.4 million of which \$3.1 million was classified as nonaccrual.

The primary benefit of the restructured multiple loan workout strategy is to maximize the potential return by restructuring the loan into a good loan (the A loan) and a bad loan (the B loan). The impact on interest is positive because the Bank is collecting interest on the A loan rather than potentially foregoing interest on the entire original loan structure. The A loan is underwritten pursuant to the Bank s standard requirements and graded accordingly. The B loan is classified as either doubtful or loss . An impairment analysis is performed on the B loan, and, based on its results, all or a portion of the B note is charged-off or a specific loan loss reserve is established.

The Company does not modify its nonaccrual policies in this arrangement, and the A loan and the B loan stand on their own terms. At the time of its inception, this structure meets the definition of a TDR. If the loan is on nonaccrual at the time of restructure, the A loan is held on nonaccrual until six consecutive payments have been received, at which time it may be put back on an accrual status. Once the A loan has received 12 consecutive payments, it may no longer be reported as a TDR. The B loan is placed on nonaccrual. Under the terms of each loan, the borrower s payment is contractually due.

A further breakout of nonaccrual loans, excluding covered loans, at September 30, 2010 and December 31, 2009 is below (dollars in thousands):

|                                   | September 30, 2010    |                   |                        | December 31, 2009     |                   |                        |
|-----------------------------------|-----------------------|-------------------|------------------------|-----------------------|-------------------|------------------------|
|                                   | Amount of Non Accrual | Non-Covered Loans | % of Non-Covered Loans | Amount of Non Accrual | Non-Covered Loans | % of Non-Covered Loans |
| Mortgage loans on real estate:    |                       |                   |                        |                       |                   |                        |
| Residential 1-4 family            | \$ 10,925             | \$ 144,319        | 7.57%                  | \$ 4,750              | \$ 146,141        | 3.25%                  |
| Commercial                        | 4,593                 | 210,812           | 2.18%                  | 3,861                 | 188,991           | 2.04%                  |
| Construction and land development | 23,964                | 110,581           | 21.67%                 | 10,115                | 144,297           | 7.01%                  |
| Second mortgages                  | 187                   | 11,093            | 1.69%                  | 194                   | 13,935            | 1.39%                  |
| Multifamily                       |                       | 10,754            |                        |                       | 11,995            |                        |
| Agriculture                       |                       | 4,030             |                        |                       | 5,516             |                        |
| Total real estate loans           | 39,669                | 491,589           | 8.07%                  | 18,920                | 510,875           | 3.70%                  |
| Commercial loans                  | 3,312                 | 43,980            | 7.53%                  | 174                   | 42,157            | 0.41%                  |
| Consumer installment loans        | 317                   | 10,223            | 3.10%                  | 910                   | 14,145            | 6.43%                  |
| All other loans                   |                       | 2,087             |                        | 7                     | 12,205            | 0.06%                  |
| Gross loans                       | \$ 43,298             | \$ 547,879        | 7.90%                  | \$ 20,011             | \$ 579,382        | 3.45%                  |

See Note 3 to the Company s financial statements for information related to the allowance for loan losses. At September 30, 2010 and December 31, 2009, total impaired non-covered loans equaled \$127.1 million and \$56.5 million, respectively. Management has adopted a nine point risk rating system for which credits are continually monitored for proper classification. The increase in impaired loans demonstrates weakening economic conditions specifically in the real estate market and management s determination that these credits warrant substandard or worse classification

Impaired loans, by definition, are loans where management believes that it is more likely than not that the borrower will not be able to fully meet its contractual obligations, including all principal and interest payments. Under the Company s current internal loan grading system, this includes all loans adversely classified substandard or worse. These impaired loans have been determined through analysis, appraisals, or other methods used by management.

## **Table of Contents**

At September 30, 2010, the Company had 25 construction and land development credit relationships with developers. The borrowers under 21 of these relationships are residential land developers, and the borrowers under the remaining four are commercial land developers. All of the relationships are secured by the real estate to be developed, and almost all of such projects are in the Company's central Virginia market. Two relationships representing a total outstanding balance of \$2.8 million were less than 50% complete, five relationships representing a total outstanding balance of \$5.6 million were more than 50% and less than 75% complete, five relationships representing a total outstanding balance of \$10.1 million were more than 75% and less than 100% complete, and 13 relationships representing a total outstanding balance of \$4.4 million were 100% complete. The total amount of the credit exposure outstanding at September 30, 2010 was \$22.9 million.

During the third quarter of 2010, the Company charged off \$5.5 million with respect to six of these relationships, one of which was a commercial land borrower in the amount of \$2.4 million. The total amount of the allowance to loan losses attributed to all 25 relationships was \$7.7 million at September 30, 2010, or 33.7% of the total credit exposure outstanding. The Company establishes its reserves as described above in *Allowance for Loan Losses on Non-covered loans* in the Critical Accounting Policies section. In conjunction with the impairment analysis the Company performs as part of its allowance methodology in the third quarter of 2010, the Company ordered appraisals for all loans with balances in excess of \$250,000 unless there existed an appraisal that was not older than 12 months. The Company orders an automated valuation for balances between \$100,000 and \$250,000 and uses a ratio analysis for balances less than \$100,000. The Company maintains detailed analysis and other information for its allowance methodology, both for internal purposes and for review by its regulators.

### ***Asset Quality covered assets***

Loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans.

The Company makes an estimate of the total cash flows that it expects to collect from a pool of covered loans, which include undiscounted expected principal and interest. Over the life of the loan or pool, the Company continues to estimate cash flows expected to be collected. Subsequent decreases in cash flows expected to be collected over the life of the pool are recognized as impairment in the current period through the allowance for loan losses. Subsequent increases in expected cash flows are first used to reverse any existing valuation allowance for that loan or pool. Any remaining increase in cash flows expected to be collected is recognized as an adjustment to the yield over the remaining life of the pool. An impairment charge of \$880,000 was posted to the allowance for loan losses during the period ended September 30, 2010 and no impairment charge was taken at December 31, 2009.

Covered assets that would normally be considered nonperforming except for the accounting requirements regarding purchased impaired loans and other real estate owned covered by the FDIC shared loss agreements at September 30, 2010 and December 31, 2009 are as follows;

**Table of Contents**

| (dollars in thousands)                   | September 30, 2010 | December 31, 2009 |
|--|--------------------|-------------------|
| Nonaccrual covered loans <sup>(1)</sup>  | \$ 22,993          | \$ 49,906         |
| Fair value adjustment                    | (12,608)           | (22,199)          |
| Nonaccrual covered loans at fair value   | 10,385             | 27,707            |
| Other real estate owned (OREO) - covered | 10,104             | 12,822            |
| Total nonperforming covered assets       | \$ 20,489          | \$ 40,529         |

<sup>(1)</sup> Amount is based on contractual book value. Contractual book value of total covered loans is \$200.9 million and \$242.0 million at September 30, 2010 and December 31, 2009, respectively. In accordance with ASC 310, covered loans are recorded at carrying value of \$123.2 million and \$150.9 million at September 30, 2010 and December 31, 2009, respectively.

**Capital Requirements**

The determination of capital adequacy depends upon a number of factors, such as asset quality, liquidity, earnings, growth trends and economic conditions. The Company seeks to maintain a strong capital base to support its growth and expansion plans, provide stability to current operations and promote public confidence in the Company.

The federal banking regulators have defined three tests for assessing the capital strength and adequacy of banks, based on two definitions of capital. Tier 1 Capital is defined as a combination of common and qualifying preferred stockholders' equity less goodwill. Tier 2 Capital is defined as qualifying subordinated debt and a portion of the allowance for loan losses. Total Capital is defined as Tier 1 Capital plus Tier 2 Capital. Three risk-based capital ratios are computed using the above capital definitions, total assets and risk-weighted assets and are measured against regulatory minimums to ascertain adequacy. All assets and off-balance sheet risk items are grouped into categories according to degree of risk and assigned a risk-weighting and the resulting total is risk-weighted assets. Tier 1 Risk-based Capital is Tier 1 Capital divided by risk-weighted assets. Total Risk-based Capital is Total Capital divided by risk-weighted assets. The leverage ratio is Tier 1 Capital divided by total average assets.

The Company's ratio of Total Risk Based Capital was 14.2% as of September 30, 2010. The ratio of Tier 1 Risk Based Capital was 13.0% as of September 30, 2010. The Company's leverage ratio was 7.5% as of September 30, 2010. All capital ratios exceed regulatory minimums. In the fourth quarter of 2003, BOE issued trust preferred subordinated debt that qualifies as regulatory capital. This trust preferred debt, which has been assumed by the Company, has a 30-year maturity with a 5-year call option and was issued at a rate of three month LIBOR plus 3.00%. The weighted average cost of this instrument was 3.5% during the quarter ended September 30, 2010.

**Liquidity**

Liquidity represents the Company's ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest bearing deposits with banks, federal funds sold, and certain investment securities. As a result of the Company's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and meet its customers' credit needs.

The Company's results of operations are significantly affected by its ability to manage effectively the interest rate sensitivity and maturity of its interest-earning assets and interest bearing liabilities. At September 30, 2010, the Company's interest-earning assets exceeded its interest bearing liabilities by \$32.6 million, as compared with \$29.8 million at December 31, 2009.

**Table of Contents****Off-Balance Sheet Arrangements and Contractual Obligations**

A summary of the contract amount of the Bank's exposure to off-balance sheet risk as of September 30, 2010 and December 31, 2009, is as follows (dollars in thousands):

|  | September 30, 2010 | December 31, 2009 |
|--|--------------------|-------------------|
| <b>Commitments with Off-Balance Sheet Risks</b>    |                    |                   |
| Commitments to extend credit                       | \$ 69,736          | \$ 88,668         |
| Standby letters of credit                          | 12,166             | 15,284            |
| <br>Total commitments with off-balance sheet risks | <br>\$ 81,902      | <br>\$ 103,952    |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. Those lines of credit may be drawn upon only to the total extent to which the Bank is committed.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. The Bank holds certificates of deposit, deposit accounts, and real estate as collateral supporting those commitments for which collateral is deemed necessary.

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

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates or prices such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The Company's primary market risk exposure is interest rate risk. The ongoing monitoring and management of interest rate risk is an important component of the Company's asset/liability management process, which is governed by policies established by its Board of Directors that are reviewed and approved annually. The Board of Directors delegates responsibility for carrying out asset/liability management policies to the Asset/Liability Committee (ALCO) of the Bank. In this capacity, ALCO develops guidelines and strategies that govern the Company's asset/liability management related activities, based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company's financial instruments also change, affecting net interest income, the primary component of the Company's earnings. ALCO uses the results of a detailed and dynamic simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. While ALCO routinely monitors simulated net interest income sensitivity over various periods, it also employs additional tools to monitor potential longer-term interest rate risk.

**Table of Contents**

The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all assets and liabilities reflected on the Company's balance sheet. The simulation model is prepared and updated monthly. This sensitivity analysis is compared to ALCO policy limits, which specify a maximum tolerance level for net interest income exposure over a one-year horizon, assuming no balance sheet growth, given a 200 basis point upward shift and a 200 basis point downward shift in interest rates. A parallel shift in rates over a 12-month period is assumed. The following table represents the change to net interest income given interest rate shocks up and down 100 and 200 basis points at September 30, 2010:

| Change in Yield curve | Change in net interest income |            |
|-----------------------|-------------------------------|------------|
|                       | %                             | \$         |
| +200 bp               | (4.8)%                        | \$ (1,990) |
| +100 bp               | (2.7)%                        | (1,111)    |
| most likely           | 0%                            |            |
| 100 bp                | 5.0%                          | 2,062      |
| 200 bp                | 10.5%                         | 4,320      |

At September 30, 2010, the Company's interest rate risk model indicated that, in a rising rate environment of 200 basis points over a 12 month period, net interest income could decrease by 4.8%. For the same time period, the interest rate risk model indicated that in a declining rate environment of 200 basis points, net interest income could increase by 10.5%. While these percentages are subjective based upon assumptions used within the model, management believes the balance sheet is appropriately balanced with acceptable risk to changes in interest rates.

The preceding sensitivity analysis does not represent a forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions, including the nature and timing of interest rate levels such as yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment or replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances about the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to factors such as prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change, caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other internal and external variables. Furthermore, the sensitivity analysis does not reflect actions that ALCO might take in response to, or in anticipation of, changes in interest rates.

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

As of the end of the period covered by this Form 10-Q, the Company's management, with the participation of the Company's chief banking officer, who has assumed the responsibilities of the chief executive officer, and chief financial officer (the Certifying Officers), conducted evaluations of the Company's disclosure controls and procedures. As defined under Section 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including the Certifying Officers, to allow timely decisions regarding required disclosures.

---

**Table of Contents**

Based on this evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were not effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Exchange Act and the rules and regulations promulgated under it. The Certifying Officers based this conclusion on the fact that the Company had a material weakness with respect to its internal controls relating to the financial reporting process for the Company's periodic reports.

Additional information with respect to the issue described above is included in the discussion below.

**Internal Control over Financial Reporting**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Certifying Officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with generally accepted accounting principles.

In the Company's Annual Report on Form 10-K for the year ended December 31, 2009, management's assessment of the effectiveness of the Company's internal control over financial reporting cited material weaknesses in the Company's internal controls relating to the financial reporting process for the Company's periodic reports and relating to the determination of specific reserves on impaired loans. A material weakness is a significant deficiency (as defined in the Public Company Accounting Oversight Board's Auditing Standard No. 5), or combination of deficiencies, such that there is a reasonable possibility that a material misstatement in the annual or interim financial statements will not be prevented or detected on a timely basis by employees in the normal course of their work. While management is not required to re-assess the effectiveness of internal control over financial reporting during the fiscal year, the Company has concluded that these material weaknesses continue to exist as of September 30, 2010, as described below.

For the first nine months of 2010 and as of September 30, 2010, management concluded that the Company's financial and accounting department lacked sufficient resources and expertise to address properly the issues that it must address on a quarterly basis and that the Company's policies and procedures have not provided for timely review of financial-related matters and related accounting entries. The Company's financial and accounting department has been understaffed for the accounting complexities that it has had to address over the past two years. This department has had to evaluate numerous non-routine accounting issues, such as issues relating to the shared loss agreements with the FDIC, in addition to focusing on the day-to-day fiscal operations of the Company and periodic filings with the SEC. The Company also has unresolved comments from the SEC relating to the Company's need to amend past periodic reports to include financial statements and related information with respect to each of the Company's predecessors (TFC and BOE) and otherwise enhance disclosure relating to goodwill and intangible assets, fair value measurements, FDIC-covered assets, asset quality and other items.

The Company, formerly a special purpose acquisition company, and the Bank have grown substantially over the past two years. In May 2008, the Company merged with each of BOE, the holding company for the Bank, and TFC, the holding company for TransCommunity Bank, and, in July 2008, TransCommunity Bank merged into the Bank. In November 2008, the Bank acquired certain assets and assumed all deposit liabilities of TCB and, in January 2009, the Bank acquired certain assets and assumed all deposit liabilities of SFSB. This significant growth has put considerable strain on the Company's organizational structure and the effectiveness of risk management programs that are appropriate for the various functions of an organization of the Company's size, complexity and risk profile. Furthermore, this growth has strained the Company's control structure, including the structure that supports the effective application of policies and the execution of procedures within the operation of financial reporting controls. As of September 30, 2010, the Company had not implemented and validated the necessary procedures to ensure that it has the structure to support an effective internal control over financial reporting.

During the evaluation of these concerns, management concluded that they were the result of a material weakness in the Company's internal controls relating to the financial reporting process for the Company's periodic reports. The Company acknowledges that its financial and accounting documentation is less than satisfactory for the criteria required for the framework for effective internal control over financial reporting.

## **Table of Contents**

In addition, management has concluded that the Company has not historically produced and maintained adequate documentation to support the impairment value assigned to potentially troubled loans, as required by ASC 310. For example, impairment worksheets often do not include important data regarding the most recent valuation, and deductions from the most recent valuation are not delineated or supported. While the Company believes that these concerns have not adversely affected the ultimate determination of the Company's allowance for loan losses and provision for loan losses, management concluded that they were the result of a material weakness in the Company's internal controls relating to the determination of specific reserves on impaired loans.

### **Remediation Steps to Address Material Weakness**

To address the issues described above, the Company has been taking remediation steps over the past 18 months. The Company continues to evaluate its financial accounting staff levels and expertise and to implement appropriate oversight and review procedures.

During the third quarter of 2009, the Company engaged an independent consulting firm to support the Company in its assessment of the Company's quarterly post-closing process, its assessment of the internal control processes in the Company's financial and accounting department to ensure that all key controls are identified and that the controls and process are appropriately documented and provide qualified resources to support the Company's chief financial officer and chief accounting officer. During the first quarter of 2010, this firm provided an assessment of the strengths and weaknesses of the financial and accounting department, and management restructured certain roles, responsibilities and functions in the department. In addition, the Company engaged an independent accounting firm to support the Company with the accounting for the loan portfolio in its Maryland market subject to the FDIC shared loss agreements. Finally, in January 2010, the Company hired both a financial reporting manager and an assistant controller and, in May 2010, appointed the financial reporting manager as its controller and chief accounting officer. The Company believes that all of these steps will remediate the material weakness in the Company's internal controls relating to the financial reporting process for the Company's periodic reports once it is able to validate their results during its formal assessment of the effectiveness of internal control over financial reporting as of December 31, 2010.

Beginning in the third quarter of 2009, under the oversight of its Board of Directors and its various committees, the Company has been establishing comprehensive internal remediation plans for issues that it has identified with respect to internal audit and other controls, and each plan requires the completion of corrective actions, identifies members of management as responsible parties and sets completion dates for addressing issues. These plans include the review, adoption and implementation of numerous formal policies and procedures appropriate for controls of an organization of the Company's size and complexity. The Company believes that these actions have positively affected the Company's internal control over financial reporting in the limited time that they have been implemented and that they will continue to positively affect such controls in the future.

To address the material weakness relating to the production and maintenance of adequate documentation to support the impairment value assigned to potentially troubled loans, the Company adopted enhanced policy and procedures for the allowance for loan losses in September 2010. As set forth in such policy and procedures, each quarter, the Company prepares supporting data and other source data to support the major components of the calculation of the allowance and to provide further credibility and reliability of the calculation. Under this quarterly process, all impaired loans require a complete impairment analysis that is accompanied by specified documentation and ultimately included in the FAS 114 allowance calculation. The Company also creates documentation supporting the Company's estimate of losses under FAS 5, which is based on historical losses, external environmental factors, internal environmental factors and an unallocated adjustment. The Company believes that this process will remediate the material weakness in the Company's internal controls with respect to this issue once it is able to validate it during its formal assessment of the effectiveness of internal control over financial reporting as of December 31, 2010.



---

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. *Legal Proceedings***

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the Company's business, to which the Company, including its subsidiaries, is a party or of which the property of the Company is subject.

**Item 1A. *Risk Factors***

Except for the additional risk factors presented below, there were no material changes to the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 and the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2010.

**We expect to enter into a written agreement with our banking regulators, which will require us to designate a significant amount of resources to comply with the agreement.**

We have worked closely with our regulators as we have attempted to address the issues involved in integrating the four predecessor banks and their different cultures and concerns with asset quality and the uncertainty of the real estate markets and general economy in our markets. In light of these discussions, and as a result of the regulators' examinations, we expect that we will enter into a written agreement with the Federal Reserve Bank of Richmond and Virginia's Bureau of Financial Institutions in the first quarter of 2011. At this time, we do not know the exact contents of such an action, but we expect that it will include provisions that address, among other matters, our development of credit risk management practices appropriate for our size, complexity and risk profile and the enhancement of our overall system for managing credit risk. A written agreement will require us to take certain actions, including the adoption of written plans or programs to address these issues that must be approved by regulators and implemented promptly upon receipt of such approval.

We expect the written agreement to also address formally the ability of management and our Board of Directors to properly oversee the remediation of identified issues. We have thoroughly reviewed current management and Board skills and are in the process of developing and implementing enhanced corporate governance structures and principles.

We expect that our management and Board will continue to focus considerable time and attention on taking corrective actions to comply with the terms of the anticipated written agreement. There also is no guarantee that we will successfully address the regulators' concerns in the written agreement or that we will be able to comply with it. If we do not comply with the written agreement, we could be subject to the assessment of civil monetary penalties, further regulatory sanctions and/or regulatory enforcement actions.

**We are not paying dividends on shares of our common stock or preferred stock and are deferring interest payments with respect to our trust preferred securities, and we may not be able to pay future dividends.**

In 2010, we suspended the payment of dividends with respect to shares of our common stock, and we began to defer dividend payments with respect to the preferred stock that we issued to the United States Department of Treasury in connection with our participation in the TARP Capital Purchase Program and interest payments with respect to our trust preferred securities. We are not able to make any of these payments until our financial position improves, and we expect that the written agreement described above will require written regulatory approval before we are able to recommence them. In addition, our ability to pay dividends is limited by general regulatory restrictions and the need to maintain sufficient capital in our organization. The ability of our bank subsidiary to pay dividends to us is limited by the Bank's obligations to maintain sufficient capital, earnings and liquidity and by other general restrictions on dividends under federal and state bank regulatory requirements.

**Table of Contents**

Dividend payments on our preferred stock and interest payments on our trust preferred securities are cumulative and, therefore, unpaid payments will accrue and compound on each subsequent dividend payment date. If the dividends on the preferred stock have not been paid for an aggregate of six quarterly dividend periods or more, whether or not consecutive, our authorized number of directors will be automatically increased by two and the holders of the preferred stock will have the right to elect those directors at our next annual meeting or at a special meeting called for that purpose. These two directors will be elected annually and will serve until all accrued and unpaid dividends for all past dividend periods have been declared and paid in full. Furthermore, we cannot pay dividends on our outstanding shares of preferred stock or our common stock until we have paid in full all deferred interest payments on our trust preferred securities.

Accordingly, there is no assurance that we will be able to resume paying cash dividends. Even if we are allowed to resume paying dividends again, the future payment of cash dividends on our common stock, if any, will be subject to the prior payment of all unpaid dividends and deferred interest on our preferred stock and trust preferred securities.

**The impact of financial reform legislation is uncertain.**

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act institutes a wide range of reforms that will have an impact on all financial institutions. The Act includes, among other things, changes to the deposit insurance and financial regulatory systems, enhanced bank capital requirements and new requirements designed to protect consumers in financial transactions. Many of these provisions are subject to rule making procedures and studies that will be conducted in the future, and thus the full effects of the legislation on us cannot yet be determined. However, these provisions, or any other aspects of current proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities or change certain of our business practices, including our ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to our operations in order to comply, and could therefore also materially adversely affect our business, financial condition, and results of operations.

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

None.

**Item 3. *Defaults upon Senior Securities***

None.

**Item 4. *(Removed and Reserved)*****Item 5. *Other Information***

None.

**Item 6. *Exhibits***

| Exhibit No. | Description   |
|-------------|---|
| 31.1        | Rule 13a-14(a)/15d-14(a) Certification for Chief Executive Officer* |

## Edgar Filing: Community Bankers Trust Corp - Form 10-Q

|      |   |
|------|---|
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification for Chief Financial Officer* |
| 32.1 | Section 1350 Certifications*  |

\* Filed herewith.

Table of Contents

**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.

COMMUNITY BANKERS TRUST CORPORATION  
(Registrant)

/s/ Rex L. Smith, III  
Rex L. Smith, III  
Executive Vice President  
(principal executive officer)

Date: November 9, 2010

/s/ Bruce E. Thomas  
Bruce E. Thomas  
Executive Vice President and Chief Financial Officer  
(principal financial officer)

Date: November 9, 2010