APPLIED ENERGETICS, INC.
Form SC 13G/A
February 16, 2010

CUSIP No. 03819M106

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

SCHEDULE 13G

Under the Securities Exchange Act of 1934

(Amendment No. 4)

Applied Energetics, Inc.

(Name of Issuer)

Common Stock

(Title of Class of Securities)

03819M106

(CUSIP Number)

December 31, 2009

(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the rule pursuant to which this Schedule is filed:

[X] Rule 13d-1(b)

[X] Rule 13d-1(c)

[ ] Rule 13d-1(d)

* The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter the disclosures provided in a prior cover page.

The information required in the remainder of this cover page shall not be deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 ("Act") or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

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CUSIP No. 03819M106

1. Names of Reporting Persons.

Artis Capital Management, L.P.

2. Check the Appropriate Box if a Member of a Group (See Instructions)

(a)

(b) X

3. SEC Use Only

4. Citizenship or Place of Organization CA

Number of Shares	5.	Sole Voting Power	0
Beneficially Owned by	6.	Shared Voting Power	6,657,129
Each Reporting	7.	Sole Dispositive Power	0
Person With:	8.	Shared Dispositive Power	6,657,129

9. Aggregate Amount Beneficially Owned by Each Reporting Person6,657,129

10. Check if the Aggregate Amount in Row (9) Excludes Certain Shares (See Instructions)______

11. Percent of Class Represented by Amount in Row (9) 7.5%

12. Type of Reporting Person (See Instructions) PN, IA

CUSIP No. 03819M106

1. Names of Reporting Persons.

Artis Capital Management, Inc.

2. Check the Appropriate Box if a Member of a Group (See Instructions)

(a)

(b) X

3. SEC Use Only

4. Citizenship or Place of Organization CA

Number of Shares Beneficially Owned by Each Reporting Person With:	5.	Sole Voting Power	0
	6.	Shared Voting Power	6,657,129
	7.	Sole Dispositive Power	0
	8.	Shared Dispositive Power	6,657,129

9. Aggregate Amount Beneficially Owned by Each Reporting Person 6,657,129

10. Check if the Aggregate Amount in Row (9) Excludes Certain Shares (See Instructions)______

11. Percent of Class Represented by Amount in Row (9) 7.5%

12. Type of Reporting Person (See Instructions) CO, HC

CUSIP No. 03819M106

1. Names of Reporting Persons.

Stuart L. Peterson

2. Check the Appropriate Box if a Member of a Group (See Instructions)

(a)

(b) X

3. SEC Use Only

4. Citizenship or Place of Organization U.S.A.

Number of Shares Beneficially Owned by Each Reporting Person With:	5.	Sole Voting Power	0
	6.	Shared Voting Power	6,657,129
	7.	Sole Dispositive Power	0
	8.	Shared Dispositive Power	6,657,129

9. Aggregate Amount Beneficially Owned by Each Reporting Person6,657,129

10. Check if the Aggregate Amount in Row (9) Excludes Certain Shares (See Instructions)______

11. Percent of Class Represented by Amount in Row (9) 7.5%

12. Type of Reporting Person (See Instructions) IN, HC

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CUSIP No. 03819M106

Item 1.

(a) Name of Issuer

Applied Energetics, Inc.

(b) Address of Issuer's Principal Executive Offices

3590 East Columbia Street, Tucson, AZ 85714

Item 2.

(a) The names of the persons filing this statement are:

Artis Capital Management, L.P. ("Artis"), Artis Capital Management, Inc. ("Artis Inc.") and Stuart L. Peterson (collectively, the "Filers")

(b) The principal business office of the Filers is located at:

One Market Plaza, Steuart Street Tower, Suite 2700, San Francisco, CA 94105 (as to Artis, Artis Inc. and Mr. Peterson)

(c) For citizenship of Filers, see Item 4 of the cover sheet for each Filer.

(d) This statement relates to shares of common stock of the Issuer (the "Stock").

(e) The CUSIP number of the Issuer is: 03819M106

CUSIP No. 03819M106

Item 3. If this statement is filed pursuant to rule 240.13d-1(b) or 240.13d-2(b) or (c), check whether the person filing is a:

(a) [ ] Broker or dealer registered under section 15 of the Act (15 U.S.C. 78o).

(b) [ ] Bank as defined in section 3(a)(6) of the Act (15 U.S.C. 78c).

(c) [ ] Insurance company as defined in section 3(a)(19) of the Act (15 U.S.C. 78c).

(d) [ ] Investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

(e) [x] An investment adviser in accordance with section 240.13d-1(b)(1)(ii)(E) (as to Artis).

(f) [ ] An employee benefit plan or endowment fund in accordance with section 240.13d-1(b)(1)(ii)(F).

(g) [x] A parent holding company or control person in accordance with 240.13d-1(b)(1)(ii)(G) (as to Artis Inc. and Mr. Peterson).

(h) [ ] A savings association as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(i) [ ] A church plan that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3).

(j) [ ] A non-U.S. institution in accordance with §240.13d-1(b)(ii)(J).

(k) [ ] Group, in accordance with Rule 13d-1(b)(1)(ii)(K).

If filing as a non-U.S. institution in accordance with §240.13d-1(b)(1)(ii)(J), please specify the type of institution ____.

Item 4. Ownership.

See Items 5-9 and 11 of the cover page for each Filer.

Item 5. Ownership of Five Percent or Less of a Class

If this statement is being filed to report the fact that as of the date hereof the reporting person has ceased to be the beneficial owner of more than five percent of the class of securities, check the following. [ ].

Item 6. Ownership of More than Five Percent on Behalf of Another Person.

Artis is an investment adviser whose clients have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, the Stock. No individual client holds more than five percent of the outstanding Stock.

Item 7. Identification and Classification of the Subsidiary Which Acquired the Security Being Reported on By the Parent Holding Company.

Not applicable.

Item 8. Identification and Classification of Members of the Group.

The Filers are filing this Schedule 13G jointly, but not as members of a group, and each expressly disclaims membership in a group. Artis is a registered investment adviser and is the investment adviser of investment funds that hold the Stock for the benefit of the investors in those funds. Artis Inc. is the general partner of Artis. Mr. Peterson is the president of Artis Inc. and the controlling owner of Artis and Artis Inc. Each of Artis, Artis Inc. and Mr. Peterson disclaims beneficial ownership of the Stock, except to the extent of that person's pecuniary interest therein.

Item 9. Notice of Dissolution of Group

Not applicable.

Item 10. Certification.

Certification

By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were acquired and are held in the ordinary course of business and were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.

Exhibits

Exhibit A Joint Filing Agreement.

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Dated: February 11, 2010

ARTIS CAPITAL MANAGEMENT, L.P.

By: Robert A. Riemer
Chief Compliance Officer

CUSIP No. 03819M106

EXHIBIT A

AGREEMENT REGARDING JOINT FILING
OF STATEMENT ON SCHEDULE 13D OR 13G

The undersigned agree to file jointly with the Securities and Exchange Commission (the "SEC") any and all statements on Schedule 13D or Schedule 13G (and any amendments or supplements thereto) required under section 13(d) of the Securities Exchange Act of 1934, as amended, in connection with purchases by the undersigned of the securities of any issuer. For that purpose, the undersigned hereby constitute and appoint Artis Capital Management, L.P., a California limited partnership, as their true and lawful agent and attorney-in-fact, with full power and authority for and on behalf of the undersigned to prepare or cause to be prepared, sign, file with the SEC and furnish to any other person all certificates, instruments, agreements and documents necessary to comply with section 13(d) and section 16(a) of the Securities Exchange Act of 1934, as amended, in connection with said purchases, and to do and perform every act necessary and proper to be done incident to the exercise of the foregoing power, as fully as the undersigned might or could do if personally present.

Dated: February 11, 2010

ARTIS CAPITAL MANAGEMENT, L.P. ARTIS CAPITAL MANAGEMENT, INC.

By: Robert A. Riemer, Chief Compliance Officer

By: Stuart L. Peterson, President

Stuart L. Peterson

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: right; font-family: "Times New Roman", Times, serif; font-size: 10pt; margin-left: 0pt;">314 $653 $364 $528 $892

Non-farm, non-residential

- 289 289 - 295 295

Consumer real estate loans

Home equity lines

- 135 135 - 145 145

Single family owner occupied

1,675 5,978 7,653 1,565 6,496 8,061

Owner occupied construction

- 228 228 - 233 233

Consumer and other loans

Consumer loans

- 36 36 - 37 37

Total TDRs

$2,014 $6,980 $8,994 $1,929 $7,734 $9,663

Allowance for loan losses related to TDRs

$581 $642

(1) Nonaccrual TDRs are included in total nonaccrual loans disclosed in the nonaccrual table above.

The following table presents interest income recognized on TDRs for the periods indicated:

Three Months Ended	Six Months Ended June 30,

	June 30,			
	2018	2017	2018	2017
(Amounts in thousands)				
Interest income recognized	$ 64	$ 1	$ 134	$ 85

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

	Three Months Ended June 30,					
	2018			2017		
(Amounts in thousands)	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment(1)	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment(1)
Below market interest rate						
Single family owner occupied	-	$ -	$ -	1	$ 241	$ 241
Below market interest rate and extended payment term						
Single family owner occupied	-	-	-	5	949	949
Total	-	$ -	$ -	6	$ 1,190	$ 1,190

(1) Represents the loan balance immediately following modification

	Six Months Ended June 30,					
	2018			2017		
(Amounts in thousands)	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment(1)	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment(1)
Below market interest rate						
Single family owner occupied	-	$ -	$ -	1	$ 241	$ 241
Below market interest rate and extended payment term						
Single family owner occupied	-	-	-	5	949	949
Total	-	$ -	$ -	6	$ 1,190	$ 1,190

(1) Represents the loan balance immediately following modification

There were no payment defaults on loans modified as TDRs that were restructured within the previous 12 months as of June 30, 2018 or 2017.

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

	June 30, 2018	December 31, 2017
(Amounts in thousands)		
Non-covered OREO	$4,805	$ 2,409
Covered OREO	44	105
Total OREO	$4,849	$ 2,514
Non-covered OREO secured by residential real estate	$3,384	$ 2,209
Residential real estate loans in the foreclosure process[1]	8,338	9,921

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

Note 5. Allowance for Loan Losses

The following tables present the changes in the allowance for loan losses, by loan segment, during the periods indicated. There was no allowance related to PCI loans as of June 30, 2018, or December 31, 2017.

	Three Months Ended June 30, 2018			
(Amounts in thousands)	**Commercial**	**Consumer Real Estate**	**Consumer and Other**	**Total Allowance**
Total allowance				
Beginning balance	$11,778	$ 6,963	$ 759	$ 19,500
(Recovery of) provision for loan losses charged to operations	(684)	906	273	495
Charge-offs	(328)	(124)	(298)	(750)
Recoveries	136	122	80	338
Net charge-offs	(192)	(2)	(218)	(412)
Ending balance	$10,902	$ 7,867	$ 814	$ 19,583

	Six Months Ended June 30, 2018			
(Amounts in thousands)	**Commercial**	**Consumer Real Estate**	**Consumer and Other**	**Total Allowance**
Total allowance				

Beginning balance	$11,672	$ 6,810	$ 794	$ 19,276
(Recovery of) provision for loan losses charged to operations	(725)	1,143	572	990
Charge-offs	(469)	(255)	(724)	(1,448)
Recoveries	424	169	172	765
Net charge-offs	(45)	(86)	(552)	(683)
Ending balance	$10,902	$ 7,867	$ 814	$ 19,583

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	Three Months Ended June 30, 2017			
(Amounts in thousands)	**Commercial**	**Consumer Real Estate**	**Consumer and Other**	**Total Allowance**
Allowance, excluding PCI				
Beginning balance	$11,972	$ 5,734	$ 740	$ 18,446
Provision for loan losses charged to operations	379	240	319	938
Charge-offs	(257)	(321)	(324)	(902)
Recoveries	189	149	58	396
Net charge-offs	(68)	(172)	(266)	(506)
Ending balance	$12,283	$ 5,802	$ 793	$ 18,878
PCI allowance				
Beginning balance	$-	$ 12	$ -	$ 12
Recovery of loan losses	-	(4)	-	(4)
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Recovery of loan losses charged to operations	-	(4)	-	(4)
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Ending balance	$-	$ 8	$ -	$ 8
Total allowance				
Beginning balance	$11,972	$ 5,746	$ 740	$ 18,458
Provision for loan losses	379	236	319	934
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Provision for loan losses charged to operations	379	236	319	934
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Charge-offs	(257)	(321)	(324)	(902)
Recoveries	189	149	58	396
Net charge-offs	(68)	(172)	(266)	(506)
Ending balance	$12,283	$ 5,810	$ 793	$ 18,886

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(Amounts in thousands)	**Six Months Ended June 30, 2017**			
	Commercial	**Consumer Real Estate**	**Consumer and Other**	**Total Allowance**
Allowance, excluding PCI				
Beginning balance	$11,690	$ 5,487	$ 759	$ 17,936
Provision for loan losses charged to operations	464	486	480	1,430
Charge-offs	(286)	(398)	(575)	(1,259)
Recoveries	415	227	129	771
Net recoveries (charge-offs)	129	(171)	(446)	(488)
Ending balance	$12,283	$ 5,802	$ 793	$ 18,878
PCI allowance				
Beginning balance	$-	$ 12	$ -	$ 12
Recovery of loan losses	-	(4)	-	(4)
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Recovery of loan losses charged to operations	-	(4)	-	(4)
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Ending balance	$-	$ 8	$ -	$ 8
Total allowance				
Beginning balance	$11,690	$ 5,499	$ 759	$ 17,948
Provision for loan losses	464	482	480	1,426
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Provision for loan losses charged to operations	464	482	480	1,426
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Charge-offs	(286)	(398)	(575)	(1,259)
Recoveries	415	227	129	771
Net recoveries (charge-offs)	129	(171)	(446)	(488)
Ending balance	$12,283	$ 5,810	$ 793	$ 18,886

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

	June 30, 2018			
(Amounts in thousands)	**Loans Individually Evaluated for Impairment(1)**	**Allowance for Loans Individually Evaluated**	**Loans Collectively Evaluated for Impairment**	**Allowance for Loans Collectively Evaluated**
Commercial loans				
Construction, development, and other land	$ -	$ -	$ 57,375	$ 369
Commercial and industrial	-	-	96,602	538
Multi-family residential	-	-	110,067	997
Single family non-owner occupied	-	-	139,813	1,416
Non-farm, non-residential	1,378	473	618,953	6,783
Agricultural	-	-	8,895	100
Farmland	929	105	21,126	121
Total commercial loans	2,307	578	1,052,831	10,324
Consumer real estate loans				
Home equity lines	67	67	111,616	680
Single family owner occupied	7,043	2,434	512,818	4,525
Owner occupied construction	-	-	22,647	161
Total consumer real estate loans	7,110	2,501	647,081	5,366
Consumer and other loans				
Consumer loans	-	-	68,885	814
Other	-	-	4,636	-
Total consumer and other loans	-	-	73,521	814
Total loans, excluding PCI loans	$ 9,417	$ 3,079	$ 1,773,433	$ 16,504

	December 31, 2017			
(Amounts in thousands)	**Loans Individually Evaluated for Impairment(1)**	**Allowance for Loans Individually Evaluated**	**Loans Collectively Evaluated for Impairment**	**Allowance for Loans Collectively Evaluated**
Commercial loans				
Construction, development, and other land	$ -	$ -	$ 59,386	$ 830
Commercial and industrial	343	270	91,845	492
Multi-family residential	-	-	125,202	1,094
Single family non-owner occupied	770	62	139,093	1,914
Non-farm, non-residential	1,367	15	611,477	6,582
Agricultural	-	-	7,035	51
Farmland	1,219	233	24,430	129
Total commercial loans	3,699	580	1,058,468	11,092

Consumer real estate loans				
Home equity lines	-	-	115,807	803
Single family owner occupied	9,471	1,978	496,348	3,732
Owner occupied construction	-	-	39,178	297
Total consumer real estate loans	9,471	1,978	651,333	4,832
Consumer and other loans				
Consumer loans	-	-	70,772	794
Other	-	-	5,001	-
Total consumer and other loans	-	-	75,773	794
Total loans, excluding PCI loans	$ 13,170	$ 2,558	$ 1,785,574	$ 16,718

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

	June 30, 2018		December 31, 2017	
(Amounts in thousands)	Recorded Investment	Allowance for Loan Pools With Impairment	Recorded Investment	Allowance for Loan Pools With Impairment
Commercial loans				
Waccamaw commercial	$1,330	$ -	$64	$ -
Peoples commercial	4,479	-	4,279	-
Other	923	-	986	-
Total commercial loans	6,732	-	5,329	-
Consumer real estate loans				
Waccamaw serviced home equity lines	7,662	-	11,118	-
Waccamaw residential	823	-	994	-
Peoples residential	964	-	999	-
Total consumer real estate loans	9,449	-	13,111	-
Total PCI loans	$16,181	$ -	$18,440	$ -

Management believed the allowance was adequate to absorb probable loan losses inherent in the loan portfolio as of June 30, 2018.

Note 6. FDIC Indemnification Asset

In connection with the FDIC-assisted acquisition of Waccamaw Bank (“Waccamaw”) in 2012, the Company entered into loss share agreements with the FDIC that covered $22.92 million of loans and $44 thousand of OREO as of June 30, 2018, compared to $27.95 million of loans and $105 thousand of OREO as of December 31, 2017. Under the loss share agreements, the FDIC agrees to cover 80% of most loan and foreclosed real estate losses and reimburse certain expenses incurred in relation to these covered assets. Loss share coverage expired June 30, 2017, for commercial loans, with recoveries continuing until June 30, 2019. Loss share coverage will expire June 30, 2022, for single family loans. The Company’s consolidated statements of income include the expense on covered assets net of estimated reimbursements. The following table presents the changes in the FDIC indemnification asset during the periods indicated:

	Three Months Ended June 30,	Six Months Ended June 30,

	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Beginning balance	$6,884	$9,931	$7,161	$12,173
Increase in estimated losses on covered OREO	-	61	-	67
Reimbursable expenses from the FDIC	(15)	159	(21)	61
Net amortization	(575)	(1,586)	(957)	(2,918)
Payments to (reimbursements from) the FDIC	96	(406)	207	(1,224)
Ending balance	$6,390	$8,159	$6,390	$8,159

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Note 7. Deposits

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

	June 30, 2018	December 31, 2017
(Amounts in thousands)		
Noninterest-bearing demand deposits	$462,851	$454,143
Interest-bearing deposits:		
Interest-bearing demand deposits	462,334	465,407
Money market accounts	156,421	170,731
Savings deposits	352,693	342,064
Certificates of deposit	350,582	374,373
Individual retirement accounts	119,857	123,173
Total interest-bearing deposits	1,441,887	1,475,748
Total deposits	$1,904,738	$1,929,891

Note 8. Borrowings

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

	June 30, 2018			December 31, 2017		
(Amounts in thousands)	Balance	Weighted Average Rate		Balance	Weighted Average Rate	
Short-term borrowings						
Retail repurchase agreements	$2,869	0.06	%	$5,086	0.07	%
Long-term borrowings						
Wholesale repurchase agreements	25,000	3.18	%	25,000	3.18	%
FHLB advances	50,000	4.00	%	50,000	4.00	%
Total borrowings	$77,869			$80,086		

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

The following schedule presents the contractual maturities of repurchase agreements, by type of collateral pledged, as of June 30, 2018:

(Amounts in thousands)	**U.S. Agency Securities**	**Municipal Securities**	**Single Issue Trust Preferred Securities**	**Mortgage-backed Agency Securities**	**Corporate Securities**	**Total**
Overnight and continuous	$ -	$ 1,235	$ -	$ 1,557	$ -	$2,792
Up to 30 days	-	-	-	-	-	-
30 - 90 days	-	-	-	-	-	-
Greater than 90 days	5,154	-	8,072	10,845	1,006	25,077
	$ 5,154	$ 1,235	$ 8,072	$ 12,402	$ 1,006	$27,869

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The following schedule presents the contractual and weighted average maturities of long-term borrowings, by year, as of June 30, 2018:

(Amounts in thousands)	Wholesale Repurchase Agreements	FHLB Borrowings	Total
2018	$ -	$ -	$-
2019	25,000	-	25,000
2020	-	-	-
2021	-	50,000	50,000
2022	-	-	-
2023 and thereafter	-	-	-
Total	$ 25,000	$ 50,000	$75,000
Weighted average maturity (in years)	0.66	2.52	1.90

The Company pledged certain loans to secure the FHLB advance and letters of credit totaling $888.31 million as of June 30, 2018. The FHLB letters of credit provide an attractive alternative to pledging securities for public unit deposits. Unused borrowing capacity with the FHLB totaled $371.96 million, net of FHLB letters of credit of $139.18 million, as of June 30, 2018. The prepayment of the advance may result in substantial penalties based on the differential between the contractual note and current advance rate for similar maturities.

The Company maintains a $15.00 million unsecured, committed line of credit with an unrelated financial institution with an interest rate of one-month LIBOR plus 2.00% that matures in April 2019. There was no outstanding balance on the line as of June 30, 2018, or December 31, 2017.

Note 9. Derivative Instruments and Hedging Activities

As of June 30, 2018, the Company’s derivative instruments consisted of interest rate swaps. Generally, derivative instruments help the Company manage exposure to market risk and meet customer financing needs. Market risk represents the possibility that fluctuations in external factors such as interest rates, market-driven loan rates, prices, or other economic factors will adversely affect economic value or net interest income.

The Company uses interest rate swap contracts to modify its exposure to interest rate risk caused by changes in the LIBOR curve in relation to certain designated fixed rate loans. These instruments are used to convert these fixed rate loans to an effective floating rate. If the LIBOR rate falls below the loan's stated fixed rate for a given period, the Company will owe the floating rate payer the notional amount times the difference between LIBOR and the stated fixed rate. If LIBOR is above the stated rate for a given period, the Company will receive payments based on the notional amount times the difference between LIBOR and the stated fixed rate. The Company's interest rate swaps qualify as fair value hedging instruments; therefore, fair value changes in the derivative and hedged item attributable to the hedged risk are recognized in earnings in the same period.

The Company enters into various interest rate swap agreements for individual loan hedging. The swap agreements, which are accounted for as fair value hedges, and the loans hedged by the agreements are recorded at fair value. The fair value hedges were effective as of June 30, 2018. The following table presents the notional, or contractual, amounts and fair values of derivative instruments as of the dates indicated:

	June 30, 2018			**December 31, 2017**		
	Notional or	**Fair Value**		**Notional or**	**Fair Value**	
(Amounts in thousands)	**Contractual Amount**	**Derivative Assets**	**Derivative Liabilities**	**Contractual Amount**	**Derivative Assets**	**Derivative Liabilities**
Derivatives designated as hedges						
Interest rate swaps	$5,649	$ 99	$ -	$5,813	$ -	$ 90
Total derivatives	$5,649	$ 99	$ -	$5,813	$ -	$ 90

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

(Amounts in thousands)	**Three Months Ended June 30, 2018**	**2017**	**Six Months Ended June 30, 2018**	**2017**	**Income Statement Location**
Derivatives designated as hedges					
Interest rate swaps	$ 8	$ 19	$ 21	$ 41	Interest and fees on loans
Total derivative expense	$ 8	$ 19	$ 21	$ 41	

Note 10. Employee Benefit Plans

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

	Three Months Ended June 30,		**Six Months Ended June 30,**		
	2018	**2017**	**2018**	**2017**	**Income Statement Location**
(Amounts in thousands)					
Service cost	$ 55	$ 58	$ 123	$ 116	Salaries and employee benefits
Interest cost	90	93	179	186	Other expense
Amortization of prior service cost	55	57	114	114	Other expense
Amortization of losses	16	8	28	15	Other expense
Net periodic cost	$ 216	$ 216	$ 444	$ 431	

Note 11. Earnings per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands, except share and per share data)				
Net income	$9,066	$6,418	$17,934	$12,620
Weighted average common shares outstanding, basic	16,689,398	17,012,189	16,821,842	17,005,196
Dilutive effect of potential common shares				
Stock options	69,914	47,591	62,384	50,356
Restricted stock	29,303	23,052	28,646	20,409
Total dilutive effect of potential common shares	99,217	70,643	91,030	70,765
Weighted average common shares outstanding, diluted	16,788,615	17,082,832	16,912,872	17,075,961
Basic earnings per common share	$0.54	$0.38	$1.06	$0.74
Diluted earnings per common share	0.54	0.38	1.06	0.74
Antidilutive potential common shares				
Stock options	-	71,592	-	59,473
Restricted stock	1,793	5,276	867	3,565
Total potential antidilutive shares	1,793	76,868	867	63,038

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Note 12. Accumulated Other Comprehensive Income (Loss)

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

	Three Months Ended June 30, 2018		
	Unrealized Gains (Losses) on Available-for-Sale Securities	Employee Benefit Plans	Total
(Amounts in thousands)			
Beginning balance	$(722)	$ (1,759)	$(2,481)
Other comprehensive (loss) income before reclassifications	(233)	73	(160)
Reclassified from AOCI	-	56	56
Other comprehensive (loss) income, net	(233)	129	(104)
Ending balance	$(955)	$ (1,630)	$(2,585)

	Three Months Ended June 30, 2017		
	Unrealized Gains (Losses) on Available-for-Sale Securities	Employee Benefit Plans	Total
(Amounts in thousands)			
Beginning balance	$(137)	$ (1,344)	$(1,481)
Other comprehensive income before reclassifications	1,028	-	1,028
Reclassified from AOCI	411	41	452
Other comprehensive income, net	1,439	41	1,480
Ending balance	$1,302	$ (1,303)	$(1)

	Six Months Ended June 30, 2018		
	Unrealized Gains (Losses) on	Employee Benefit Plans	Total

	Available-for-Sale Securities		
(Amounts in thousands)			
Beginning balance	$975	$ (1,815)	$(840)
Other comprehensive (loss) income before reclassifications	(1,930)	73	(1,857)
Reclassified from AOCI	-	112	112
Other comprehensive (loss) income, net	(1,930)	185	(1,745)
Ending balance	$(955)	$ (1,630)	$(2,585)

	Six Months Ended June 30, 2017		
	Unrealized Gains (Losses) on Available-for-Sale Securities	**Employee Benefit Plans**	**Total**
(Amounts in thousands)			
Beginning balance	$(544)	$ (1,467)	$(2,011)
Other comprehensive income before reclassifications	1,435	83	1,518
Reclassified from AOCI	411	81	492
Other comprehensive income, net	1,846	164	2,010
Ending balance	$1,302	$ (1,303)	$(1)

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

(Amounts in thousands)	**Three Months Ended June 30, 2018**	**2017**	**Six Months Ended June 30, 2018**	**2017**	**Income Statement Line Item Affected**
Available-for-sale securities					
Loss recognized	$-	$657	$-	$657	Net loss on sale of securities
Reclassified out of AOCI, before tax	-	657	-	657	Income before income taxes
Income tax expense	-	246	-	246	Income tax expense
Reclassified out of AOCI, net of tax	-	411	-	411	Net income
Employee benefit plans					
Amortization of prior service cost	$55	$57	$114	$114	(1)
Amortization of net actuarial benefit cost	16	8	28	15	(1)
Reclassified out of AOCI, before tax	71	65	142	129	Income before income taxes
Income tax expense	15	24	30	48	Income tax expense
Reclassified out of AOCI, net of tax	56	41	112	81	Net income
Total reclassified out of AOCI, net of tax	$56	$452	$112	$492	Net income

(1) Amortization is included in net periodic pension cost. See Note 10, "Employee Benefit Plans."

Note 13. Fair Value

Financial Instruments Measured at Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The fair value hierarchy ranks the inputs used in measuring fair value as follows:

Level 1 – Observable, unadjusted quoted prices in active markets
Level 2 – Inputs other than quoted prices included in Level 1 that are directly or indirectly observable for the asset or liability
Level 3 – Unobservable inputs with little or no market activity that require the Company to use reasonable inputs and assumptions

The Company uses fair value measurements to record adjustments to certain financial assets and liabilities on a recurring basis. The Company may be required to record certain assets at fair value on a nonrecurring basis in specific circumstances, such as evidence of impairment. Methodologies used to determine fair value might be highly subjective and judgmental in nature; therefore, valuations may not be precise. If the Company determines that a valuation technique change is necessary, the change is assumed to have occurred at the end of the respective reporting period. The following discussion describes the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments under the valuation hierarchy.

Assets and Liabilities Reported at Fair Value on a Recurring Basis

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

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

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

Loans Held for Investment. Loans held for investment are reported at fair value using the exit price notion, which is derived from third-party models. Loans related to fair value hedges are recorded at fair value on a recurring basis.

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

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

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

	June 30, 2018			
	Total	**Fair Value Measurements Using**		
(Amounts in thousands)	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale debt securities				
U.S. Agency securities	$1,170	$-	$1,170	$-
U.S. Treasury securities	49,808	-	49,808	-
Municipal securities	99,605	-	99,605	-
Single issue trust preferred securities	8,983	-	8,983	-
Mortgage-backed Agency securities	36,859	-	36,859	-
Total available-for-sale debt securities	196,425	-	196,425	-
Equity securities	55	55	-	-
Fair value loans	5,765	-	-	5,765
Deferred compensation assets	3,652	3,652	-	-
Derivative assets	99	-	99	-
Deferred compensation liabilities	3,652	3,652	-	-

	December 31, 2017			
	Total	**Fair Value Measurements Using**		
(Amounts in thousands)	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale debt securities				
U.S. Agency securities	$11,296	$-	$11,296	$ -
U.S. Treasury securities	19,971	-	19,971	-
Municipal securities	103,648	-	103,648	-
Single issue trust preferred securities	8,884	-	8,884	-
Mortgage-backed Agency securities	21,726	-	21,726	-
Total available-for-sale debt securities	165,525	-	165,525	-
Equity securities	55	55	-	-
Fair value loans	5,739	-	5,739	-
Deferred compensation assets	4,002	4,002	-	-
Deferred compensation liabilities	4,002	4,002	-	-
Derivative liabilities	90	-	90	-

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Beginning in 2018, the Company measured the fair value of loans held for investment using an exit price notion in according with the adoption of ASU 2016-01. Prior to 2018, loans held for investment were reported at fair value using discounted future cash flows that apply current interest rates for loans with similar terms and borrower credit quality. As a result of using the exit price, certain loans were transferred from Level 2 into Level 3 of the fair value hierarchy during the six months ended June 30, 2018. No transfers into or out of Level 3 of the fair value hierarchy occurred during the six months ended June 30, 2017.

Assets Measured at Fair Value on a Nonrecurring Basis

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

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

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

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

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

	June 30, 2018			
	Total	**Fair Value Measurements Using**		
	Fair Value	**Level 1**	**Level 2**	**Level 3**
(Amounts in thousands)				
Impaired loans, non-covered	$5,819	$-	$ -	$5,819
OREO, non-covered	4,389	-	-	4,389
OREO, covered	32	-	-	32

	December 31, 2017			
	Total	**Fair Value Measurements Using**		
	Fair Value	**Level 1**	**Level 2**	**Level 3**
(Amounts in thousands)				
Impaired loans, non-covered	$5,015	$-	$ -	$5,015
OREO, non-covered	2,359	-	-	2,359
OREO, covered	105	-	-	105

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Quantitative Information about Level 3 Fair Value Measurements

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

	Valuation Technique	**Unobservable Input**	**Discount Range (Weighted Average)** June 30, 2018	December 31, 2017
Impaired loans, non-covered	Discounted appraisals(1)	Appraisal adjustments(2)	7% to 100% (35%)	6% to 79% (34%)
OREO, non-covered	Discounted appraisals(1)	Appraisal adjustments(2)	10% to 100% (31%)	8% to 47% (32%)
OREO, covered	Discounted appraisals(1)	Appraisal adjustments(2)	49% to 49% (49%)	0% to 65% (52%)

(1) Fair value is generally based on appraisals of the underlying collateral.
(2) Appraisals may be adjusted by management for customized discounting criteria, estimated sales costs, and proprietary qualitative adjustments.

Fair Value of Financial Instruments

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

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

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

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

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

Deposits and Securities Sold Under Agreements to Repurchase. Deposits and repurchase agreements with fixed maturities and rates are reported at fair value using discounted future cash flows that apply interest rates available in the market for instruments with similar characteristics and maturities.

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

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

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

	June 30, 2018				
	Carrying		**Fair Value Measurements Using**		
(Amounts in thousands)	**Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets					
Cash and cash equivalents	$107,957	$107,957	$107,957	$-	$-
Debt securities available for sale	196,425	196,425	-	196,425	-
Debt securities held to maturity	25,082	24,980	-	24,980	-
Equity securities	55	55	55	-	-
Loans held for investment, net of allowance	1,779,448	1,740,502	-	-	1,740,502
FDIC indemnification asset	6,390	3,216	-	-	3,216
Interest receivable	5,580	5,580	-	5,580	-
Derivative financial assets	99	99	-	99	-
Deferred compensation assets	3,652	3,652	3,652	-	-
Liabilities					
Time deposits	470,439	459,771	-	459,771	-
Securities sold under agreements to repurchase	27,869	27,978	-	27,978	-
Interest payable	1,089	1,089	-	1,089	-
FHLB and other borrowings	50,000	51,399	-	51,399	-
Deferred compensation liabilities	3,652	3,652	3,652	-	-

	December 31, 2017				
	Carrying		**Fair Value Measurements Using**		
(Amounts in thousands)	**Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets					
Cash and cash equivalents	$157,951	$157,951	$157,951	$-	$-
Debt securities available for sale	165,525	165,525	-	165,525	-
Debt securities held to maturity	25,149	25,084	-	25,084	-
Equity securities	55	55	55	-	-
Loans held for investment, net of allowance	1,797,908	1,760,606	-	5,739	1,754,867
FDIC indemnification asset	7,161	3,927	-	-	3,927
Interest receivable	5,778	5,778	-	5,778	-
Deferred compensation assets	4,002	4,002	4,002	-	-
Liabilities					
Demand deposits	454,143	454,143	-	454,143	-
Interest-bearing demand deposits	465,407	465,407	-	465,407	-
Savings deposits	512,795	512,795	-	512,795	-
Time deposits	497,546	490,628	-	490,628	-
Securities sold under agreements to repurchase	30,086	30,449	-	30,449	-
Interest payable	1,104	1,104	-	1,104	-
FHLB and other borrowings	50,000	52,702	-	52,702	-

Derivative financial liabilities	90	90	-	90	-
Deferred compensation liabilities	4,002	4,002	4,002	-	-

Note 14. Litigation, Commitments, and Contingencies

Litigation

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

Commitments and Contingencies

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

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

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

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

	June 30, 2018	**December 31, 2017**
(Amounts in thousands)		
Commitments to extend credit	$220,150	$243,147
Standby letters of credit and financial guarantees[1]	144,430	131,587
Total off-balance sheet risk	364,580	374,734
Reserve for unfunded commitments	$66	$66

(1) Includes FHLB letters of credit

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand our financial condition, changes in financial condition, and results of operations. MD&A contains forward-looking statements and should be read in conjunction with our consolidated financial statements, accompanying notes, and other financial information included in this report and our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"). Unless the context suggests otherwise, the terms "First Community," "Company," "we," "our," and "us" refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity.

Executive Overview

First Community Bancshares, Inc. (the "Company") is a financial holding company, headquartered in Bluefield, Virginia, that provides banking products and services through its wholly owned subsidiary First Community Bank (the "Bank"), a Virginia chartered bank institution. As of June 30, 2018, the Bank operated 44 branches as First Community Bank in Virginia, West Virginia, and North Carolina and as People's Community Bank, a Division of First Community Bank, in Tennessee. As of June 30, 2018, full-time equivalent employees, calculated using the number of hours worked, totaled 532. Our primary source of earnings is net interest income, the difference between interest earned on assets and interest paid on liabilities, which is supplemented by fees for services, commissions on sales, and various deposit service charges. We fund our lending and investing activities primarily through the retail deposit operations of our branch banking network and, to a lesser extent, retail and wholesale repurchase agreements and Federal Home Loan Bank ("FHLB") borrowings. We invest our funds primarily in loans to retail and commercial customers and various investment securities. Our common stock is traded on the NASDAQ Global Select Market under the symbol, FCBC.

The Bank offers trust management, estate administration, and investment advisory services through its Trust Division and wholly owned subsidiary First Community Wealth Management ("FCWM"). The Trust Division manages inter vivos trusts and trusts under will, develops and administers employee benefit and individual retirement plans, and manages and settles estates. Fiduciary fees for these services are charged on a schedule related to the size, nature, and complexity of the account. Revenues consist primarily of commissions on assets under management and investment advisory fees. As of June 30, 2018, the Trust Division and FCWM managed $969 million in combined assets under various fee-based arrangements as fiduciary or agent.

The Bank offers insurance products and services through its wholly owned subsidiary First Community Insurance Services ("FCIS"). FCIS provides in-branch commercial and insurance services in West Virginia. Revenues are primarily derived from commissions paid by issuing companies on the sale of policies. As of June 30, 2018, FCIS operated 3 in-branch locations.

We had no acquisition and divestiture activity during the six months ended June 30, 2018, or year ended December 31, 2017.

Critical Accounting Estimates

We prepare our consolidated financial statements in accordance with generally accepted accounting principles (“GAAP”) in the U.S. and conform to general practices within the banking industry. Our financial position and results of operations may require management to make significant estimates and assumptions that have a material impact on our financial condition or operating performance. Due to the level of subjectivity and the susceptibility of such matters to change, actual results could differ significantly from management’s assumptions and estimates. Estimates, assumptions, and judgments, which are periodically evaluated, are based on historical experience and other factors, including expectations of future events believed reasonable under the circumstances. These estimates are generally necessary when assets and liabilities are required to be recorded at estimated fair value, when a decline in the value of an asset carried on the financial statements at fair value warrants an impairment write-down or a valuation reserve, or when an asset or liability needs recorded based on the probability of occurrence of a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. Fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices, when available, or third-party sources. When quoted prices or third-party information is not available, management estimates valuation adjustments primarily through the use of financial modeling techniques and appraisal estimates.

Our accounting policies are fundamental in understanding MD&A and the disclosures presented in Item 1, “Financial Statements,” of this report. Our accounting policies are described in detail in Note 1, “Basis of Presentation,” of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of the Company’s Quarterly Report on Form 10-Q for the period ended March 31, 2018, and in Note 1, “Basis of Presentation and Significant Accounting Policies,” of the Notes to Consolidated Financial Statements in Part II, Item 8 of our 2017 Form 10-K. Our critical accounting estimates are detailed in the “Critical Accounting Estimates” section in Part II, Item 7 of our 2017 Form 10-K.

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Performance Overview

Highlights of our results of operations for the three and six months ended June 30, 2018, and financial condition as of June 30, 2018, include the following:

- Pre-tax income increased $2.19 million, or 23.34%, to $11.57 million and net income increased $2.65 million, or 41.26%, to $9.07 million in the second quarter of 2018 compared to the same quarter of 2017.
- Diluted earnings per share increased $0.16, or 42.11%, to $0.54 and core diluted earnings per share increased $0.17, or 44.74%, to $0.55 in the second quarter of 2018 compared to the same quarter of 2017.
- Return on average assets improved 45 basis points to 1.53% and return on average equity improved 327 basis points to 10.68% in the second quarter of 2018 compared to the same quarter of 2017.
- Net interest margin decreased 2 basis points to 4.30%, while the normalized net interest margin increased 5 basis points to 4.04% in the second quarter of 2018 compared to the same quarter of 2017.
- The Company repurchased 286,940 common shares during the second quarter of 2018. Year to date, the Company has repurchased 474,240 common shares for $14.72 million compared to 10,602 shares during the same period of 2017.
- The Company and its subsidiary bank both significantly exceed regulatory "well capitalized" targets as of June 30, 2018.

Results of Operations

Net Income

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

	Three Months Ended June 30,		Three Months Ended Increase		Six Months Ended June 30,		Six Months Ended Increase	
(Amounts in thousands, except per share data)	**2018**	**2017**	**(Decrease)**	**% Change**	**2018**	**2017**	**(Decrease)**	**% Change**
Net income	$9,066	$6,418	$2,648	41.26 %	$17,934	$12,620	$5,314	42.11 %
Basic earnings per common share	0.54	0.38	0.17	43.99 %	1.06	0.74	0.31	42.31 %
Diluted earnings per common share	0.54	0.38	0.16	43.73 %	1.06	0.74	0.32	43.48 %

Return on average assets	1.53 %	1.08 %	0.45 %	41.67 %	1.53 %	1.07 %	0.46 %	42.99 %
Return on average common equity	10.68 %	7.41 %	3.27 %	44.13 %	10.49 %	7.38 %	3.11 %	42.14 %

Three-Month Comparison. Net income increased in the second quarter of 2018 due to increases in noninterest and net interest income and a decrease in income tax. These changes were offset by a slight increase in noninterest expense.

Six-Month Comparison. Net income increased in the first six months of 2018 due to increases in noninterest and net interest income and a decrease in income tax. These changes were offset by a slight increase in noninterest expense.

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Net Interest Income

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

	Three Months Ended June 30, 2018				**2017**			
(Amounts in thousands)	**Average Balance**	**Interest[(1)]**	**Average Yield/ Rate[(1)]**		**Average Balance**	**Interest[(2)]**	**Average Yield/ Rate[(2)]**	
Assets								
Earning assets								
Loans[(3)]	$1,795,094	$ 22,495	5.03	%	$1,843,441	$ 22,986	5.00	%
Securities available for sale	190,605	1,641	3.45	%	167,869	1,455	3.48	%
Securities held to maturity	25,098	104	1.66	%	34,664	125	1.45	%
Interest-bearing deposits	109,349	514	1.89	%	68,455	221	1.29	%
Total earning assets	2,120,146	24,754	4.68	%	2,114,429	24,787	4.70	%
Other assets	252,843				263,767			
Total assets	$2,372,989				$2,378,196			
Liabilities and stockholders' equity								
Interest-bearing deposits								
Demand deposits	$484,776	$ 104	0.09	%	$387,113	$ 60	0.06	%
Savings deposits	518,055	83	0.06	%	525,808	85	0.06	%
Time deposits	477,691	1,140	0.96	%	514,527	1,088	0.85	%
Total interest-bearing deposits	1,480,522	1,327	0.36	%	1,427,448	1,233	0.35	%
Borrowings								
Federal funds purchased	-	-	-		5	-	0.00	%
Retail repurchase agreements	3,615	1	0.11	%	60,809	10	0.07	%
Wholesale repurchase agreements	25,000	201	3.22	%	25,000	201	3.22	%
FHLB advances and other borrowings	50,000	506	4.06	%	55,635	567	4.09	%
Total borrowings	78,615	708	3.61	%	141,449	778	2.21	%
Total interest-bearing liabilities	1,559,137	2,035	0.52	%	1,568,897	2,011	0.51	%
Noninterest-bearing demand deposits	447,048				441,547			
Other liabilities	26,222				20,197			
Total liabilities	2,032,407				2,030,641			
Stockholders' equity	340,582				347,555			
Total liabilities and stockholders' equity	$2,372,989				$2,378,196			
Net interest income, FTE		$ 22,719				$ 22,776		
Net interest rate spread			4.16	%			4.19	%
Net interest margin			4.30	%			4.32	%

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

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

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	Six Months Ended June 30,					
	2018			2017		
(Amounts in thousands)	**Average Balance**	**Interest(1)**	**Average Yield/ Rate(1)**	**Average Balance**	**Interest(2)**	**Average Yield/ Rate(2)**
Assets						
Earning assets						
Loans(3)	$1,800,438	$ 45,322	5.08 %	$1,841,152	$ 44,880	4.92 %
Securities available for sale	177,897	3,025	3.43 %	164,820	2,939	3.60 %
Securities held to maturity	25,115	209	1.68 %	40,854	276	1.36 %
Interest-bearing deposits	113,627	985	1.75 %	62,140	380	1.23 %
Total earning assets	2,117,077	49,541	4.72 %	2,108,966	48,475	4.64 %
Other assets	252,592			267,163		
Total assets	$2,369,669			$2,376,129		
Liabilities and stockholders' equity						
Interest-bearing deposits						
Demand deposits	$473,819	$ 167	0.07 %	$384,098	$ 114	0.06 %
Savings deposits	518,306	165	0.06 %	525,691	169	0.06 %
Time deposits	485,574	2,246	0.93 %	515,014	2,116	0.83 %
Total interest-bearing deposits	1,477,699	2,578	0.35 %	1,424,803	2,399	0.34 %
Borrowings						
Federal funds purchased	-	-	-	3	-	0.00 %
Retail repurchase agreements	4,031	2	0.10 %	63,861	21	0.07 %
Wholesale repurchase agreements	25,000	400	3.23 %	25,000	399	3.22 %
FHLB advances and other borrowings	50,000	1,006	4.06 %	61,096	1,243	4.10 %
Total borrowings	79,031	1,408	3.59 %	149,960	1,663	2.24 %
Total interest-bearing liabilities	1,556,730	3,986	0.52 %	1,574,763	4,062	0.52 %
Noninterest-bearing demand deposits	439,867			433,588		
Other liabilities	28,168			22,822		
Total liabilities	2,024,765			2,031,173		
Stockholders' equity	344,904			344,956		
Total liabilities and stockholders' equity	$2,369,669			$2,376,129		
Net interest income, FTE		$ 45,555			$ 44,413	
Net interest rate spread			4.20 %			4.12 %
Net interest margin			4.34 %			4.25 %

(1) FTE basis based on the federal statutory rate of 21%
(2) FTE basis based on the federal statutory rate of 35%
(3) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.

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

	Three Months Ended June 30, 2018 Compared to 2017 Dollar Increase (Decrease) due to				**Six Months Ended June 30, 2018 Compared to 2017 Dollar Increase (Decrease) due to**			
(Amounts in thousands)	**Volume**	**Rate**	**Rate/ Volume**	**Total**	**Volume**	**Rate**	**Rate/ Volume**	**Total**
Interest earned on[1]								
Loans[2]	$(1,199)	$228	$ 480	$(491)	$(992)	$1,467	$ (33)	$442
Securities available-for-sale	392	(19)	(187)	186	233	(136)	(11)	86
Securities held-to-maturity	(69)	37	11	(21)	(106)	64	(25)	(67)
Interest-bearing deposits with other banks	263	200	(170)	293	315	159	131	605
Total interest earning assets	(613)	446	134	(33)	(550)	1,554	62	1,066
Interest paid on[1]								
Demand deposits	30	46	(32)	44	27	21	5	53
Savings deposits	(2)	(2)	2	(2)	(2)	(2)	-	(4)
Time deposits	(155)	278	(71)	52	(121)	266	(15)	130
Retail repurchase agreements	(19)	14	(4)	(9)	(20)	11	(10)	(19)
Wholesale repurchase agreements	-	-	-	-	-	1	-	1
FHLB advances and other borrowings	(114)	(8)	61	(61)	(226)	(14)	3	(237)
Total interest-bearing liabilities	(260)	328	(44)	24	(342)	283	(17)	(76)
Change in net interest income[1]	$(353)	$118	$ 178	$(57)	$(208)	$1,271	$ 79	$1,142

(1) FTE basis based on the federal statutory rate of 21% for periods after January 1, 2018, and 35% for periods prior to January 1, 2018

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

The following tables present the net interest analysis on a FTE basis excluding the impact of non-cash purchase accounting accretion from acquired loan portfolios for the periods indicated:

	Three Months Ended June 30, 2018		**2017**	
(Amounts in thousands)	**Interest[1]**	**Average Yield/ Rate[1]**	**Interest[2]**	**Average Yield/ Rate[2]**
Earning assets				

Loans[3]	$22,495	5.03	%	$22,986	5.00	%
Accretion income	1,827			2,534		
Less: cash accretion income	468			788		
Non-cash accretion income	1,359			1,746		
Loans, normalized[4]	21,136	4.72	%	21,240	4.62	%
Other earning assets	2,259	2.79	%	1,801	2.67	%
Total earning assets	23,395	4.43	%	23,041	4.37	%
Total interest-bearing liabilities	2,035	0.52	%	2,011	0.51	%
Net interest income, FTE[4]	$21,360			$21,030		
Net interest rate spread, normalized[4]		3.90	%		3.86	%
Net interest margin, normalized[4]		4.04	%		3.99	%

(1) FTE basis based on the federal statutory rate of 21%
(2) FTE basis based on the federal statutory rate of 35%
(3) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.
(4) Normalized totals are non-GAAP financial measures that exclude non-cash loan interest accretion related to PCI loans.

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	Six Months Ended June 30,					
	2018			2017		
(Amounts in thousands)	Interest(1)	Average Yield/ Rate(1)		Interest(2)	Average Yield/ Rate(2)	
Earning assets						
Loans(3)	$45,322	5.08	%	$44,880	4.92	%
Accretion income	4,151			4,318		
Less: cash accretion income	947			1,438		
Non-cash accretion income	3,204			2,880		
Loans, normalized(4)	42,118	4.72	%	42,000	4.60	%
Other earning assets	4,219	2.69	%	3,595	2.71	%
Total earning assets	46,337	4.41	%	45,595	4.36	%
Total interest-bearing liabilities	3,986	0.52	%	4,062	0.53	%
Net interest income, FTE(4)	$42,351			$41,533		
Net interest rate spread, normalized(4)		3.90	%		3.83	%
Net interest margin, normalized(4)		4.03	%		3.97	%

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

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

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

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

Three-Month Comparison. Net interest income comprised 76.04% of total net interest and noninterest income in the second quarter of 2018 compared to 81.52% in the same quarter of 2017. Net interest income on a GAAP basis decreased $32 thousand, or 0.41%, and net interest income on a FTE basis decreased $57 thousand, or 0.25%. Normalized net interest income on a FTE basis is a non-GAAP measure that excludes non-cash loan accretion income related to PCI loans. For additional information, see “Non-GAAP Financial Measures” below. Normalized net interest margin increased 5 basis points compared to a decrease of 2 basis points on a FTE basis. Normalized net interest spread increased 4 basis points compared to a decrease of 3 basis points on a FTE basis.

Average earning assets increased $5.72 million, or 0.27%, primarily due to increases in interest-bearing deposits and available-for-sale securities offset by decreases in loans. The normalized yield on earning assets increased 6 basis points compared to a decrease of 2 basis points on a GAAP basis. Average loans decreased $48.35 million, or 2.62%, and the average loan to deposit ratio decreased to 93.13% from 98.63%. The normalized yield on loans increased 10 basis points compared to an increase of 3 basis points on a GAAP basis. Non-cash accretion income decreased $387 thousand, or 22.16%, as the effect of accretion income continued to decline from acquired portfolio attrition.

Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, decreased $9.76 million, or 0.62%, primarily due to a decline in average borrowings. The yield on interest-bearing liabilities increased 1 basis point. Average borrowings decreased $62.83 million, or 44.42%, largely due to a $57.19 million, or 94.06%, decrease in average retail repurchase agreements and a $5.64 million, or 10.13%, decrease in average FHLB advances. Average interest-bearing deposits increased $53.07 million, or 3.72%, which was driven by a $97.66 million, or 25.23%, increase in average interest-bearing demand deposits offset by a $36.84 million, or 7.16%, decrease in average time deposits, and a $7.75 million, or 1.47%, decrease in average savings deposits, which include money market and savings accounts.

Six-Month Comparison. Net interest income comprised 76.61% of total net interest and noninterest income in the first six months of 2018 compared to 80.73% in the same period of 2017. Net interest income on a GAAP basis increased $1.21 million, or 2.78%, and net interest income on a FTE basis increased $1.14 million, or 2.57%. Normalized net interest margin increased 6 basis points compared to an increase of 9 basis points on a FTE basis. Normalized net interest spread increased 6 basis points compared to an increase of 7 basis points on a FTE basis.

Average earning assets increased $8.11 million, or 0.38%, primarily due to an increase in interest-bearing deposits offset by decreases in loans. The normalized yield on earning assets increased 5 basis points compared to an increase of 8 basis points on a GAAP basis. Average loans decreased $40.71 million, or 2.21%, and the average loan to deposit ratio decreased to 93.89% from 99.07%. The normalized yield on loans increased 12 basis points compared to an increase of 16 basis points on a GAAP basis. Non-cash accretion income increased $324 thousand, or 11.25%.

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Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, decreased $18.03 million, or 1.15%, primarily due to a decline in average borrowings. The yield on interest-bearing liabilities remained constant at 0.52%. Average borrowings decreased $70.93 million, or 47.30%, largely due to a $59.83 million, or 93.69%, decrease in average retail repurchase agreements and an $11.10 million, or 18.16%, decrease in average FHLB advances. Average interest-bearing deposits increased $52.90 million, or 3.71%, which was driven by an $89.72 million, or 23.36%, increase in average interest-bearing demand deposits offset by a $29.44 million, or 5.72%, decrease in average time deposits, and a $7.39 million, or 1.40%, decrease in average savings deposits, which include money market and savings accounts.

Provision for Loan Losses

Three-Month Comparison. The provision charged to operations decreased $439 thousand, or 47.00%, to $495 thousand in the second quarter of 2018 compared to the same quarter of 2017, which was attributed to the non-PCI provision. For additional information, see “Allowance for Loan Losses” in the “Financial Condition” section below.

Six-Month Comparison. The provision charged to operations decreased $436 thousand, or 30.58%, to $990 thousand in the first six months of 2018 compared to the same period of 2017, which was attributed to the non-PCI provision.

Noninterest Income

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

	Three Months Ended June 30,		**Three Months Ended Increase**		**Six Months Ended June 30,**		**Six Months Ended Increase**	
	2018	**2017**	**(Decrease)**	**% Change**	**2018**	**2017**	**(Decrease)**	**% Change**
(Amounts in thousands)								
Wealth management	$823	$791	$32	4.05 %	$1,617	$1,581	$36	2.28 %
Service charges on deposits	3,612	3,360	252	7.50 %	7,080	6,473	607	9.38 %
Other service charges and fees	1,991	1,748	243	13.90 %	3,791	3,447	344	9.98 %
Insurance commissions	338	325	13	4.00 %	667	698	(31)	-4.44 %
Net loss on sale of securities	-	(657)	657	-100.00 %	-	(657)	657	-100.00 %
Net FDIC indemnification asset amortization	(575)	(1,586)	1,011	-63.75 %	(957)	(2,918)	1,961	-67.20 %
Other operating income	827	1,074	(247)	-23.00 %	1,429	1,743	(314)	-18.01 %

Total noninterest income	$7,016	$5,055	$1,961	38.79	%	$13,627	$10,367	$3,260	31.45	%

Three-Month Comparison. Noninterest income comprised 23.96% of total net interest and noninterest income in the second quarter of 2018 compared to 18.48% in the same quarter of 2017. Noninterest income increased $1.96 million, or 38.79%, primarily due to the decrease in net negative amortization related to the FDIC indemnification asset as loss share coverage expired June 30, 2017, for commercial loans. Service charges on deposits and other service charges and fees increased $495 thousand, or 9.69%, primarily from increases in checking account fees and net interchange income. Other service charges and fees included a $163 thousand, or 12.49%, increase in net interchange income. Other operating income decreased primarily due to the recognition of $459 thousand in death proceeds from bank owned life insurance in the second quarter of 2017. Excluding the impact from sales of securities, net FDIC indemnification asset amortization, and bank owned life insurance proceeds, noninterest income increased $752 thousand, or 11.00%, to $7.59 million in the second quarter of 2018, from $6.84 million in the same quarter of 2017.

Six-Month Comparison. Noninterest income comprised 23.39% of total net interest and noninterest income in the first six months of 2018 compared to 19.27% in the same period of 2017. Noninterest income increased $3.26 million, or 31.45%, primarily due to the decrease in net negative amortization related to the FDIC indemnification asset as loss share coverage expired June 30, 2017, for commercial loans. Service charges on deposits and other service charges and fees increased $951 thousand, or 9.59%, primarily from increases in checking account fees and net interchange income. Other service charges and fees included a $270 thousand, or 10.69%, increase in net interchange income. Other operating income decreased primarily due to the recognition of $459 thousand in death proceeds from bank owned life insurance in the first six months of 2017. Excluding the impact from sales of securities, net FDIC indemnification asset amortization, and bank owned life insurance proceeds, noninterest income increased $1.10 million, or 8.17%, to $14.58 million in the first six months of 2018, from $13.48 million in the same period of 2017.

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Noninterest Expense

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

	Three Months Ended June 30,		Three Months Ended Increase		Six Months Ended June 30,		Six Months Ended Increase	
	2018	**2017**	**(Decrease)**	**% Change**	**2018**	**2017**	**(Decrease)**	**% Change**
(Amounts in thousands)								
Salaries and employee benefits	$8,993	$9,022	$(29)	-0.32 %	$18,434	$17,770	$664	3.74 %
Occupancy expense	1,083	1,341	(258)	-19.24 %	2,333	2,589	(256)	-9.89 %
Furniture and equipment expense	945	1,087	(142)	-13.06 %	1,991	2,178	(187)	-8.59 %
Service fees	851	1,095	(244)	-22.28 %	1,679	1,940	(261)	-13.45 %
Advertising and public relations	461	544	(83)	-15.26 %	983	1,149	(166)	-14.45 %
Professional fees	430	817	(387)	-47.37 %	737	1,639	(902)	-55.03 %
Amortization of intangibles	263	263	-	0.00 %	524	524	-	0.00 %
FDIC premiums and assessments	252	227	25	11.01 %	463	471	(8)	-1.70 %
Other operating expense	3,939	2,642	1,297	49.09 %	7,132	5,482	1,650	30.10 %
Total noninterest expense	$17,217	$17,038	$179	1.05 %	$34,276	$33,742	$534	1.58 %

Three-Month Comparison. Noninterest expense increased $179 thousand, or 1.05%, in the second quarter of 2018 compared to the same quarter of 2017, which was largely due to an increase in other operating expense, which included a $400 thousand increase in property write-downs and a $529 thousand increase in the net loss on sales and expenses related to other real estate owned (“OREO”) to $742 thousand from $213 thousand in the second quarter of 2017. Professional fees decreased largely due to a reduction in legal fees.

Six-Month Comparison. Noninterest expense increased $534 thousand, or 1.58%, in the first six months of 2018 compared to the same period of 2017, which was largely due to an increase in other operating expense and salaries and employee benefits. Other operating expense included a $910 thousand increase in property write-downs and a $372 thousand increase in the net loss on sales and expenses related to OREO to $913 thousand in the first six months of 2018 from $541 thousand in the first six months of 2017. Professional fees decreased largely due to a reduction in legal fees.

Income Tax Expense

Three-Month Comparison. The Company’s effective tax rate, income tax as a percent of pre-tax income, may vary significantly from the statutory rate due to permanent differences and available tax credits. Permanent differences are income and expense items excluded by law in the calculation of taxable income. The Company’s most significant permanent differences generally include interest income on municipal securities and increases in the cash surrender value of life insurance policies. The Tax Cuts and Jobs Act (“Tax Reform Act”) enacted on December 22, 2017, reduced our federal statutory income tax rate from 35% to 21% beginning January 1, 2018. Income tax expense decreased $459 thousand, or 15.51%, and the effective tax rate decreased to 21.62% in the second quarter of 2018 from 31.56% in the same quarter of 2017 primarily due to the Tax Reform Act.

Six-Month Comparison. Income tax expense decreased $946 thousand, or 15.73%, and the effective tax rate decreased to 22.03% in the second quarter of 2018 from 32.27% in the same quarter of 2017 primarily due to the Tax Reform Act.

Non-GAAP Financial Measures

In addition to financial statements prepared in accordance with GAAP, we use certain non-GAAP financial measures that management believes provide investors with important information useful in understanding our operational performance and comparing our financial measures with other financial institutions. The non-GAAP financial measures presented in this report include net interest income on a FTE basis and normalized net interest income on a FTE basis. While we believe these non-GAAP financial measures enhance understanding of our business and performance, they are supplemental and not a substitute for, or more important than, financial measures prepared on a GAAP basis. Our non-GAAP financial measures may not be comparable to those reported by other financial institutions. The reconciliations of these measures to GAAP measures are presented below.

We believe FTE basis is the preferred industry measurement of net interest income and provides better comparability between taxable and tax exempt amounts. We use this non-GAAP financial measure to monitor net interest income performance and to manage the composition of our balance sheet. The FTE basis adjusts for the tax benefits of income from certain tax exempt loans and investments using the federal statutory rate of 21% beginning January 1, 2018, and 35% prior to January 1, 2018. Normalized net interest income on a FTE basis is a non-GAAP measure that excludes non-cash loan accretion income related to PCI loans.

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Net interest income, GAAP	$22,262	$22,294	$44,641	$43,435
FTE adjustment(1)	457	482	914	978
Net interest income, FTE	22,719	22,776	45,555	44,413
Less: non-cash accretion income(2)	1,359	1,746	3,204	2,880
Net interest income, normalized	$21,360	$21,030	$42,351	$41,533
Net interest margin, GAAP	4.22 %	4.23 %	4.25 %	4.15 %
FTE adjustment(1)	0.08 %	0.09 %	0.09 %	0.10 %
Net interest margin, FTE	4.30 %	4.32 %	4.34 %	4.25 %
Less: non-cash accretion income(2)	0.26 %	0.33 %	0.31 %	0.28 %
Net interest margin, normalized	4.04 %	3.99 %	4.03 %	3.97 %

(1) FTE basis based on the federal statutory rate of 21% for periods after January 1, 2018, and 35% for periods prior to January 1, 2018

(2) Non-cash purchase accounting accretion income from acquired loan portfolios

Financial Condition

Total assets as of June 30, 2018, decreased $40.34 million, or 1.69%, to $2.35 billion from $2.39 billion as of December 31, 2017. Total liabilities as of June 30, 2018, decreased $28.75 million, or 1.41%, to $2.01 billion from $2.04 billion as of December 31, 2017.

Investment Securities

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

Available-for-sale debt securities as of June 30, 2018, increased $30.90 million, or 18.67%, compared to December 31, 2017, primarily due to the purchase of U.S. Treasury securities offset by the maturity of certain U.S. Agency securities. The market value of debt securities available for sale as a percentage of amortized cost was 99.39% as of June 30, 2018, compared to 100.75% as of December 31, 2017. Held-to-maturity debt securities as of June 30, 2018, decreased $67 thousand, or 0.27%, compared to December 31, 2017, primarily due to an increase in net unrealized losses. The market value of debt securities held to maturity as a percentage of amortized cost was 99.59% as of June 30, 2018, compared to 99.74% as of December 31, 2017.

Investment securities are reviewed quarterly for possible other-than-temporary impairment (“OTTI”) charges. We recognized no OTTI charges in earnings associated with debt securities for the three months ended June 30, 2018 or 2017. For additional information, see Note 2, “Debt Securities,” to the Condensed Consolidated Financial Statements in Item 1 of this report.

Loans Held for Investment

Loans held for investment, our largest component of interest income, are grouped into commercial, consumer real estate, and consumer and other loan segments. Each segment is divided into various loan classes based on collateral or purpose. Certain loans acquired in FDIC-assisted transactions are covered under loss share agreements (“covered loans”). Total loans held for investment, net of unearned income, as of June 30, 2018, decreased $18.15 million, or 1.01%, compared to December 31, 2017, primarily due to a $13.12 million, or 0.73%, decrease in non-covered loans, which was driven by declines in owner occupied construction, multi-family residential, and commercial construction segments. Covered loans decreased $5.03 million, or 17.99%, as the covered Waccamaw portfolio continues to pay down. For additional information, see Note 3, “Loans,” to the Condensed Consolidated Financial Statements in Item 1 of this report.

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

	June 30, 2018		December 31, 2017		June 30, 2017	
(Amounts in thousands)	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Non-covered loans held for investment						
Commercial loans						
Construction, development, and other land	$57,986	3.22 %	$60,017	3.30 %	$58,869	3.20 %
Commercial and industrial	96,614	5.37 %	92,188	5.07 %	89,455	4.86 %
Multi-family residential	110,067	6.12 %	125,202	6.89 %	141,228	7.67 %
Single family non-owner occupied	142,076	7.90 %	141,670	7.80 %	142,150	7.72 %
Non-farm, non-residential	624,999	34.74 %	616,633	33.93 %	603,272	32.75 %
Agricultural	8,895	0.49 %	7,035	0.39 %	6,086	0.33 %
Farmland	22,055	1.23 %	25,649	1.41 %	28,600	1.55 %
Total commercial loans	1,062,692	59.07 %	1,068,394	58.79 %	1,069,660	58.08 %
Consumer real estate loans						
Home equity lines	100,194	5.57 %	103,205	5.68 %	102,460	5.56 %
Single family owner occupied	517,058	28.74 %	502,686	27.66 %	500,582	27.17 %
Owner occupied construction	22,647	1.26 %	39,178	2.16 %	46,874	2.54 %
Total consumer real estate loans	639,899	35.57 %	645,069	35.50 %	649,916	35.27 %
Consumer and other loans						
Consumer loans	68,885	3.83 %	70,772	3.89 %	72,391	3.93 %
Other	4,636	0.26 %	5,001	0.28 %	4,296	0.23 %
Total consumer and other loans	73,521	4.09 %	75,773	4.17 %	76,687	4.16 %
Total non-covered loans	1,776,112	98.73 %	1,789,236	98.46 %	1,796,263	97.51 %
Total covered loans	22,919	1.27 %	27,948	1.54 %	45,845	2.49 %
Total loans held for investment, net of unearned income	1,799,031	100.00 %	1,817,184	100.00 %	1,842,108	100.00 %
Less: allowance for loan losses	19,583		19,276		18,886	
Total loans held for investment, net of unearned income and allowance	$1,779,448		$1,797,908		$1,823,222	

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

	June 30, 2018		December 31, 2017		June 30, 2017	
(Amounts in thousands)	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Commercial loans						
Construction, development, and other land	$35	0.15 %	$39	0.14 %	$3,560	7.77 %
Commercial and industrial	-	0.00 %	-	0.00 %	603	1.32 %
Single family non-owner occupied	252	1.10 %	284	1.02 %	1,020	2.22 %
Non-farm, non-residential	8	0.04 %	9	0.03 %	3,768	8.22 %
Agricultural	-	0.00 %	-	0.00 %	24	0.05 %

Farmland	-	0.00 %	-	0.00 %	376	0.82 %
Total commercial loans	295	1.29 %	332	1.19 %	9,351	20.40 %
Consumer real estate loans						
Home equity lines	19,151	83.56 %	23,720	84.87 %	30,818	67.22 %
Single family owner occupied	3,473	15.15 %	3,896	13.94 %	5,676	12.38 %
Total consumer real estate loans	22,624	98.71 %	27,616	98.81 %	36,494	79.60 %
Total covered loans	$22,919	100.00 %	$27,948	100.00 %	$45,845	100.00 %

Risk Elements

We seek to mitigate credit risk by following specific underwriting practices and by ongoing monitoring of our loan portfolio. Our underwriting practices include the analysis of borrowers' prior credit histories, financial statements, tax returns, and cash flow projections; valuation of collateral based on independent appraisers' reports; and verification of liquid assets. We believe our underwriting criteria are appropriate for the various loan types we offer; however, losses may occur that exceed the reserves established in our allowance for loan losses. We track certain credit quality indicators that include: trends related to the risk rating of commercial loans, the level of classified commercial loans, net charge-offs, nonperforming loans, and general economic conditions. The Company's loan review function generally analyzes all commercial loan relationships greater than $4.0 million annually and at various times during the year. Smaller commercial and retail loans are sampled for review during the year.

Nonperforming assets consist of nonaccrual loans, accrual loans contractually past due 90 days or more, unseasoned troubled debt restructurings ("TDRs"), and OREO. Ongoing activity in the classification and categories of nonperforming loans include collections on delinquencies, foreclosures, loan restructurings, and movements into or out of the nonperforming classification due to changing economic conditions, borrower financial capacity, or resolution efforts. Loans acquired with credit deterioration, with a discount, continue to accrue interest based on expected cash flows; therefore, PCI loans are not generally considered nonaccrual. For additional information, see Note 4, "Credit Quality," to the Condensed Consolidated Financial Statements in Item 1 of this report.

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

(Amounts in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Non-covered nonperforming			
Nonaccrual loans	$21,467	$ 18,997	$20,146
Accruing loans past due 90 days or more	-	1	-
TDRs(1)	289	120	100
Total nonperforming loans	21,756	19,118	20,246
Non-covered OREO	4,805	2,409	3,914
Total non-covered nonperforming assets	$26,561	$ 21,527	$24,160
Covered nonperforming			
Nonaccrual loans	$509	$ 342	$446
Total nonperforming loans	509	342	446
Covered OREO	44	105	124
Total covered nonperforming assets	$553	$ 447	$570
Total nonperforming			
Nonaccrual loans	$21,976	$ 19,339	$20,592
Accruing loans past due 90 days or more	-	1	-
TDRs(1)	289	120	100
Total nonperforming loans	22,265	19,460	20,692
OREO	4,849	2,514	4,038
Total nonperforming assets	$27,114	$ 21,974	$24,730
Additional Information			
Performing TDRs(2)	$6,691	$ 7,614	$8,485
Total TDRs(3)	6,980	7,734	8,585
Non-covered ratios			
Nonperforming loans to total loans	1.22 %	1.07 %	1.13 %
Nonperforming assets to total assets	1.14 %	0.91 %	1.04 %
Non-PCI allowance to nonperforming loans	90.01 %	100.83 %	93.24 %
Non-PCI allowance to total loans	1.10 %	1.08 %	1.05 %
Total ratios			
Nonperforming loans to total loans	1.24 %	1.07 %	1.12 %
Nonperforming assets to total assets	1.15 %	0.92 %	1.04 %
Allowance for loan losses to nonperforming loans	87.95 %	99.05 %	91.27 %
Allowance for loan losses to total loans	1.09 %	1.06 %	1.03 %

(1)

TDRs restructured within the past six months and nonperforming TDRs exclude nonaccrual TDRs of $82 thousand, $169 thousand, and $82 thousand for the periods ended June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

(2) TDRs with six months or more of satisfactory payment performance exclude nonaccrual TDRs of $1.93 million, $1.76 million, and $1.51 million for the periods ended June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

(3) Total TDRs exclude nonaccrual TDRs of $2.01 million, $1.93 million, and $1.59 million for the periods ended June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

Non-covered nonperforming assets as of June 30, 2018, increased $5.03 million, or 23.38%, from December 31, 2017, primarily due to an increase in non-covered nonaccrual loans and non-covered OREO. Non-covered nonaccrual loans as of June 30, 2018, increased $2.47 million, or 13.00%, from December 31, 2017. As of June 30, 2018, non-covered nonaccrual loans were largely attributed to single family owner occupied (57.84%) and non-farm, non-residential (21.73%) loans. As of June 30, 2018, approximately $1.38 million, or 6.41%, of non-covered nonaccrual loans were attributed to performing loans acquired in business combinations. Certain loans included in the nonaccrual category have been written down to estimated realizable value or assigned specific reserves in the allowance for loan losses based on management's estimate of loss at ultimate resolution.

Non-covered delinquent loans, comprised of loans 30 days or more past due and nonaccrual loans, totaled $29.44 million as of June 30, 2018, a decrease of $1.27 million, or 4.13%, compared to $30.71 million as of December 31, 2017. Non-covered delinquent loans as a percent of total non-covered loans totaled 1.66% as of June 30, 2018, which includes past due loans (0.45%) and nonaccrual loans (1.21%).

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When restructuring loans for borrowers experiencing financial difficulty, we generally make concessions in interest rates, loan terms, or amortization terms. Certain TDRs are classified as nonperforming when modified and are returned to performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs. Accruing TDRs as of June 30, 2018, decreased $754 thousand, or 9.75%, to $6.98 million from December 31, 2017. Nonperforming accruing TDRs as of June 30, 2018, increased $169 thousand to $289 thousand compared to December 31, 2017. Nonperforming accruing TDRs as a percent of total accruing TDRs totaled 4.14% as of June 30, 2018, compared to 1.55% as of December 31, 2017. Specific reserves on TDRs totaled $581 thousand as of June 30, 2018, compared to $642 thousand as of December 31, 2017.

Non-covered OREO, which is carried at the lesser of estimated net realizable value or cost, increased $891 thousand, or 22.76%, as of June 30, 2018, compared to December 31, 2017. Non-covered OREO consisted of 18 properties with an average holding period of 8 months as of June 30, 2018. The net loss on the sale of OREO totaled $671 thousand for the three months ended June 30, 2018, compared to $181 thousand for the same period of the prior year and $774 thousand for the six months ended June 30, 2018, compared to $422 thousand for the same period of the prior year. The following table presents the changes in OREO during the periods indicated:

	Six Months Ended June 30,					
	2018			**2017**		
(Amounts in thousands)	**Non-covered**	**Covered**	**Total**	**Non-covered**	**Covered**	**Total**
Beginning balance	$2,409	$ 105	$2,514	$5,109	$ 276	$5,385
Additions	3,928	-	3,928	749	26	775
Disposals	(983)	(55)	(1,038)	(1,710)	(204)	(1,914)
Valuation adjustments	(549)	(6)	(555)	(234)	26	(208)
Ending balance	$4,805	$ 44	$4,849	$3,914	$ 124	$4,038

Allowance for Loan Losses

The allowance for loan losses is maintained at a level management deems sufficient to absorb probable loan losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and recoveries of prior loan charge-offs and decreased by loans charged off. The provision for loan losses is calculated and charged to expense to bring the allowance to an appropriate level using a systematic process of measurement that requires significant judgments and estimates. As of June 30, 2018, our qualitative risk factors reflect a stable risk of loan losses due to consistent asset quality metrics and relatively stable business and economic conditions in our primary market areas. The loan portfolio is continually monitored for deterioration in credit, which may result in the need to increase the allowance for loan losses in future periods. Management considered the allowance adequate as of June 30, 2018; however, no assurance can be made that additions to the allowance will not be required in future periods. For additional information, see Note 5, “Allowance for Loan Losses,” to the Condensed Consolidated Financial Statements in Item 1 of this report.

The allowance for loan losses as of June 30, 2018, increased $307 thousand, or 1.59%, from December 31, 2017. The increase was largely attributed to a $521 thousand increase in specific reserves on impaired loans. The non-PCI allowance as a percent of non-covered loans totaled 1.10% as of June 30, 2018, compared to 1.08% as of December 31, 2017. PCI loans were aggregated into five loan pools as of June 30, 2018, and December 31, 2017: Waccamaw commercial, Waccamaw serviced home equity lines, Waccamaw residential, Peoples Bank of Virginia (“Peoples”) commercial, and Peoples residential. The cash flow analysis identified no impaired PCI loan pools as of June 30, 2018, or December 31, 2017. Net charge-offs decreased $94 thousand, or 18.58%, for the three months ended June 30, 2018, compared to the same period of the prior year, largely due to an increase in charge-offs in the consumer loan segments. Net charge-offs increased $195 thousand, or 39.96%, for the six months ended June 30, 2018, compared to the same period of the prior year, largely due to an increase in charge-offs in the commercial and consumer loan segments.

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

	Three Months Ended June 30,					
	2018			2017		
(Amounts in thousands)	Non-PCI Portfolio	PCI Portfolio	Total	Non-PCI Portfolio	PCI Portfolio	Total
Beginning balance	$19,500	$ -	$19,500	$18,446	$ 12	$18,458
Provision for (recovery of) loan losses charged to operations	495	-	495	938	(4)	934
Charge-offs	(750)	-	(750)	(902)	-	(902)
Recoveries	338	-	338	396	-	396
Net charge-offs	(412)	-	(412)	(506)	-	(506)
Ending balance	$19,583	$ -	$19,583	$18,878	$ 8	$18,886

	Six Months Ended June 30,					
	2018			2017		
(Amounts in thousands)	Non-PCI Portfolio	PCI Portfolio	Total	Non-PCI Portfolio	PCI Portfolio	Total
Beginning balance	$19,276	$ -	$19,276	$17,936	$ 12	$17,948
Provision for (recovery of) loan losses charged to operations	990	-	990	1,430	(4)	1,426
Charge-offs	(1,448)	-	(1,448)	(1,259)	-	(1,259)
Recoveries	765	-	765	771	-	771
Net charge-offs	(683)	-	(683)	(488)	-	(488)
Ending balance	$19,583	$ -	$19,583	$18,878	$ 8	$18,886

Deposits

Total deposits as of June 30, 2018, decreased $25.15 million, or 1.30%, compared to December 31, 2017. Time deposits, which include certificates of deposit and individual retirement accounts, decreased $27.11 million; savings deposits, which include money market accounts and savings accounts, decreased $3.68 million; and interest-bearing demand deposits decreased $3.07 million while noninterest-bearing demand deposits increased $8.71 million as of June 30, 2018, compared to December 31, 2017.

Borrowings

Total borrowings as of June 30, 2018, decreased $2.22 million, or 2.77%, compared to December 31, 2017 due to short-term borrowings. Short-term borrowings consisted of retail repurchase agreements, which decreased $2.22 million, or 43.59%, while the weighted average rate decreased 1 basis point to 0.06% as of June 30, 2018, compared to December 31, 2017.

Long-term borrowings consisted of a wholesale repurchase agreement and a convertible FHLB advance as of June 30, 2018. The wholesale repurchase agreement totaled $25.00 million with a weighted average contractual rate of 3.18% as of June 30, 2018, and December 31, 2017. Long-term FHLB borrowings totaled $50.00 million with a weighted average contractual rate of 4.00% as of June 30, 2018, and December 31, 2017.

Liquidity and Capital Resources

Liquidity

Liquidity is a measure of our ability to convert assets to cash or raise cash to meet financial obligations. We believe that liquidity management should encompass an overall balance sheet approach that draws together all sources and uses of liquidity. Poor or inadequate liquidity risk management may result in a funding deficit that could have a material impact on our operations. We maintain a liquidity risk management policy and contingency funding policy (“Liquidity Plan”) to detect potential liquidity issues and protect our depositors, creditors, and shareholders. The Liquidity Plan includes various internal and external indicators that are reviewed on a recurring basis by our Asset/Liability Management Committee (“ALCO”) of the Board of Directors. ALCO reviews liquidity risk exposure and policies related to liquidity management; ensures that systems and internal controls are consistent with liquidity policies; and provides accurate reports about liquidity needs, sources, and compliance. The Liquidity Plan involves ongoing monitoring and estimation of potentially credit sensitive liabilities and the sources and amounts of balance sheet and external liquidity available to replace outflows during a funding crisis. The liquidity model incorporates various funding crisis scenarios and a specific action plan is formulated, and activated, when a financial shock that affects our normal funding activities is identified. Generally, the plan will reflect a strategy of replacing liability outflows with alternative liabilities, rather than balance sheet asset liquidity, to the extent that significant premiums can be avoided. If alternative liabilities are not available, outflows will be met through liquidation of balance sheet assets, including unpledged securities.

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As a financial holding company, the Company's primary source of liquidity is dividends received from the Bank, which are subject to certain regulatory limitations. Other sources of liquidity include cash, investment securities, and borrowings. As of June 30, 2018, the Company's cash reserves totaled $22.14 million and availability on an unsecured, committed line of credit with an unrelated financial institution totaled $15.00 million. There was no outstanding balance on the line of credit as of June 30, 2018. The Company's cash reserves and investments provide adequate working capital to meet obligations, projected dividends to shareholders, and anticipated debt repayments for the next twelve months.

In addition to cash on hand and deposits with other financial institutions, we rely on customer deposits, cash flows from loans and investment securities, and lines of credit from the FHLB and the Federal Reserve Bank ("FRB") Discount Window to meet potential liquidity demands. These sources of liquidity are immediately available to satisfy deposit withdrawals, customer credit needs, and our operations. Secondary sources of liquidity include approved lines of credit with correspondent banks and unpledged available-for-sale securities. As of June 30, 2018, our unencumbered cash totaled $107.96 million, unused borrowing capacity from the FHLB totaled $371.96 million, available credit from the FRB Discount Window totaled $6.15 million, available lines from correspondent banks totaled $90.00 million, and unpledged available-for-sale securities totaled $148.67 million.

Cash Flows

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

	Six Months Ended June 30,	
	2018	**2017**
(Amounts in thousands)		
Net cash provided by operating activities	$21,142	$14,378
Net cash (used in) provided by investing activities	(15,010)	48,430
Net cash used in financing activities	(56,126)	(32,316)
Net (decrease) increase in cash and cash equivalents	(49,994)	30,492
Cash and cash equivalents, beginning balance	157,951	76,307
Cash and cash equivalents, ending balance	$107,957	$106,799

Cash and cash equivalents decreased $49.99 million for the six months ended June 30, 2018, compared to an increase of $30.49 million for the same period of the prior year primarily due to a $63.44 million reduction in net cash provided by investing activities from the purchase of available-for-sale securities. Net cash used in financing activities increased $23.81 million largely due to a net decrease in deposit accounts and an increase in cash dividends offset by the absence of repayments of FHLB and other borrowings that occurred in 2017. Net cash provided by operating activities increased $6.76 million primarily due to an increase in net income and a decrease in other operating activities.

Capital Resources

We are committed to effectively managing our capital to protect our depositors, creditors, and shareholders. Failure to meet certain capital requirements may result in actions by regulatory agencies that could have a material impact on our operations. Total stockholders' equity as of June 30, 2018, decreased $11.59 million, or 3.31%, to $339.12 million from $350.71 million as of December 31, 2017. The change in stockholders' equity was largely due to the repurchase of 474,240 shares of our common stock totaling $14.72 million and dividends declared on our common stock of $14.20 million, which includes a one-time special dividend totaling $8.13 million, offset by net income of $17.93 million. Accumulated other comprehensive loss increased $1.75 million to $2.59 million as of June 30, 2018, compared to December 31, 2017, primarily due to net unrealized losses on securities. In accordance with current regulatory guidelines, accumulated other comprehensive income/(loss) is largely excluded from stockholders' equity in the calculation of our capital ratios. Our book value per common share decreased $0.17, or 0.82%, to $20.46 as of June 30, 2018, from $20.63 as of December 31, 2017.

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Capital Adequacy Requirements

Risk-based capital guidelines, issued by state and federal banking agencies, include balance sheet assets and off-balance sheet arrangements weighted by the risks inherent in the specific asset type. Our current risk-based capital requirements, based on the international capital standards known as Basel III, became effective on January 1, 2015, subject to a four-year phase-in period. Basel III's capital conservation buffer became effective on January 1, 2016, at 0.625%, and will be phased in over a four-year period (increasing by an additional 0.625% each year until it reaches 2.5% on January 1, 2019). A description of the Basel III capital rules is included in Part I, Item 1 of the 2017 Form 10-K. Our current required capital ratios are as follows:

4.5% Common Equity Tier 1 capital to risk-weighted assets (effectively 5.75% including the capital conservation buffer)
6.0% Tier 1 capital to risk-weighted assets (effectively 7.25% including the capital conservation buffer)
8.0% Total capital to risk-weighted assets (effectively 9.25% including the capital conservation buffer)
4.0% Tier 1 capital to average consolidated assets ("Tier 1 leverage ratio")

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

	June 30, 2018		**December 31, 2017**	
	Company	**Bank**	**Company**	**Bank**
Common equity Tier 1 ratio	13.75%	12.09%	13.98%	12.47%
Tier 1 risk-based capital ratio	13.75%	12.09%	13.98%	12.47%
Total risk-based capital ratio	14.88%	13.21%	15.06%	13.55%
Tier 1 leverage ratio	10.58%	9.28%	11.06%	9.84%

Our risk-based capital ratios as of June 30, 2018, decreased from December 31, 2017, due to a decrease in Tier 1 and total risk-based capital. As of June 30, 2018, we continued to meet all capital adequacy requirements and were classified as well-capitalized under the regulatory framework for prompt corrective action. Management believes there have been no conditions or events since those notifications that would change the Bank's classification. Additionally, our capital ratios were in excess of the minimum standards under the Basel III capital rules on a fully phased-in basis, if such requirements were in effect, as of June 30, 2018.

Off-Balance Sheet Arrangements

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

	June 30, 2018	**December 31, 2017**
(Amounts in thousands)		
Commitments to extend credit	$220,150	$243,147
Financial letters of credit	600	250
Performance letters of credit[(1)]	143,830	131,337
Total off-balance sheet risk	$364,580	$374,734
Reserve for unfunded commitments	$66	$66

(1) Includes FHLB letters of credit

Market Risk and Interest Rate Sensitivity

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

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

During the second quarter of 2018, the Federal Open Market Committee increased the benchmark federal funds rate to a range of 175 to 200 basis points. The following table presents the sensitivity of net interest income from immediate and sustained rate shocks in various interest rate scenarios over a twelve-month period for the periods indicated. Due to the current target rate, we do not reflect a decrease of more than 100 basis points from current rates in our analysis.

	June 30, 2018		**December 31, 2017**	
Increase (Decrease) in Basis Points	**Change in Net Interest Income**	**Percent Change**	**Change in Net Interest Income**	**Percent Change**
(Dollars in thousands)				
300	$661	0.8 %	$3,759	4.3 %
200	677	0.8 %	2,756	3.2 %
100	482	0.6 %	1,535	1.8 %
(100)	(3,982)	-4.5 %	(4,405)	-5.1 %

We have established policy limits for tolerance of interest rate risk in various interest rate scenarios and exposure limits to changes in the economic value of equity. As of June 30, 2018, exposure to interest rate risk is within our defined policy limits.

The Company primarily uses derivative instruments to manage exposure to market risk and meet customer financing needs. As of June 30, 2018, we maintained interest rate swap agreements with notional amounts totaling $5.65 million to modify our exposure to interest rate risk caused by changes in the LIBOR curve in relation to certain designated fixed rate loans. The fair values of the swap agreements, which are accounted for as fair value hedges, were recorded as a derivative asset totaling $99 thousand as of June 30, 2018, and a derivative liability totaling $90 thousand as of December 31, 2017. For additional information, see Note 9, “Derivative Instruments and Hedging Activities,” to the

Condensed Consolidated Financial Statements in Item 1 of this report.

Inflation and Changing Prices

Our consolidated financial statements and related notes are presented in accordance with GAAP, which requires the measurement of results of operations and financial position in historical dollars. Inflation may cause a rise in price levels and changes in the relative purchasing power of money. These inflationary effects are not reflected in historical dollar measurements. The primary effect of inflation on our operations is increased operating costs. In management's opinion, interest rates have a greater impact on our financial performance than inflation. Interest rates do not necessarily fluctuate in the same direction, or to the same extent, as the price of goods and services; therefore, the effect of inflation on businesses with large investments in property, plant, and inventory is generally more significant than the effect on financial institutions. The U.S. inflation rate continues to be relatively stable, and management believes that any changes in inflation will not be material to our financial performance.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The information required in this item is incorporated by reference to "Market Risk and Interest Rate Sensitivity" in Item 1 of this report.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In connection with this report, we conducted an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures under the Exchange Act Rule 13a-15(b). Based upon that evaluation, the CEO and CFO concluded that, as of June 30, 2018, our disclosure controls and procedures were effective.

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

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

Changes in Internal Control over Financial Reporting

We assess the adequacy of our internal control over financial reporting quarterly and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2018, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

Our risk factors discuss potential events, trends, or other circumstances that could adversely affect our business, financial condition, results of operations, cash flows, liquidity, access to capital resources, and, consequently, cause the market value of our common stock to decline. These risks could cause our future results to differ materially from historical results and expectations of future financial performance. If any of the risks occur and the market price of our common stock declines significantly, individuals may lose all, or part, of their investment in our Company. Individuals should carefully consider our risk factors and information included, or incorporated by reference, in this report before making an investment decision. There may be risks and uncertainties that we have not identified or that we have deemed immaterial that could adversely affect our business; therefore, the following risk factors are not intended to be an exhaustive list of all risks we face. There have been no material changes to the risk factors included in Part I, Item 1A, "Risk Factors," of our 2017 Form 10-K.

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

(a) Not Applicable

(b) Not Applicable

(c) Issuer Purchases of Equity Securities

We repurchased 286,940 shares of our common stock during the second quarter of 2018 compared to 3,802 shares during the same quarter of 2017 and 474,240 shares during the first six months of 2018 compared to 10,602 shares during the same period of 2017.

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

	Total Number of Shares Purchased	**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of a Publicly Announced Plan**	**Maximum Number of Shares that May Yet be Purchased Under the Plan(1)**
April 1-30, 2018	81,630	$ 30.49	81,630	389,294
May 1-30, 2018	152,120	32.69	152,120	237,187
June 1-30, 2018	53,190	34.44	53,190	1,792,568
Total	286,940	$ 32.39	286,940	

(1) On June 27, 2018, our Board of Directors increased the number of shares authorized under the stock repurchase plan by 1,600,000 shares. Our stock repurchase plan, as amended, authorizes the purchase and retention of up to 6,600,000 shares. The plan has no expiration date and is currently in effect. No determination has been made to terminate the plan or to cease making purchases. We held 4,807,432 shares in treasury as of June 30, 2018.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

Exhibit No.	Exhibit Description	Exhibit No.	Form	Dated	Filed	Filed Herewith
2.1	Agreement and Plan of Reincorporation and Merger between First Community Bancshares, Inc. and First Community Bankshares, Inc.	Appendix A	the Definitive Proxy Statement on Form DEF 14A	4/24/2018	3/13/2018	
3.1	Articles of Incorporation of First Community Bancshares, Inc., as amended	3(i)	Form 10-Q	6/30/2010	8/16/2010	
3.2	Amended and Restated Bylaws of First Community Bancshares, Inc.	3.1	Form 8-K	2/23/2016	2/25/2016	
4.1	Specimen stock certificate of First Community Bancshares, Inc.	4.1	Form 10-K	12/31/2002	3/25/2003	
10.1.1**	First Community Bancshares, Inc. 1999 Stock Option Plan	10.1	Form 10-K/A	12/31/1999	4/13/2000	
10.1.2**	Amendment One to the First Community Bancshares, Inc. 1999 Stock Option Plan	10.1.1	Form 10-Q	3/31/2004	5/7/2004	
10.2**	First Community Bancshares, Inc. 1999 Stock Option Agreement	10.5	Form 10-Q	6/30/2002	8/14/2002	
10.3**	First Community Bancshares, Inc. 2001 Nonqualified Director Stock Option Agreement	10.4	Form 10-Q	6/30/2002	8/14/2002	
10.4**	First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan	Annex B	the Definitive Proxy Statement on Form DEF 14A	4/27/2004	3/15/2004	
10.5**	First Community Bancshares, Inc. 2004 Omnibus Stock Option Plan Stock Award Agreement	10.13	Form 10-Q	6/30/2004	8/6/2004	
10.6**	First Community Bancshares, Inc. 2012 Omnibus Equity Compensation Plan	Appendix B	the Definitive Proxy Statement on Form DEF 14A	4/24/2012	3/7/2012	
10.7**	First Community Bancshares, Inc. 2012 Omnibus Equity Compensation Plan Restricted Stock Grant Agreement	99.1	Form 8-K	5/28/2013	5/28/2013	

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10.8**	First Community Bancshares, Inc. Life Insurance Endorsement Method Split Dollar Plan and Agreement	10.5	Form 10-K/A	12/31/1999	4/13/2000	
10.9.1**	First Community Bancshares, Inc. and Affiliates Executive Retention Plan	10.1	Form 8-K	12/30/2008	1/5/2009	
10.9.2**	Amendment #1 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan	10.3	Form 8-K	12/16/2010	12/17/2010	
10.9.3**	Amendment #2 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan	10.1	Form 8-K	2/21/2013	2/25/2013	
10.9.4**	Amendment #3 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan	10.1	Form 8-K	5/24/2016	5/31/2016	
10.9.5**	Amendment #4 to the First Community Bancshares, Inc. and Affiliates Executive Retention Plan	10.1	Form 8-K	2/28/2017	2/28/2017	
10.10**	Amended and Restated Deferred Compensation Plan for Directors of First Community Bancshares, Inc. and Affiliates	99.2	Form 8-K	8/22/2006	8/23/2006	
10.11.1**	First Community Bancshares, Inc. Amended and Restated Nonqualified Supplemental Cash or Deferred Retirement Plan	99.1	Form 8-K	8/22/2006	8/23/2006	
10.11.2**	Amendment #2 to the First Community Bancshares, Inc. Amended and Restated Nonqualified Supplemental Cash or Deferred Retirement Plan	10.2	Form 8-K	2/28/2017	2/28/2017	
10.12.1**	First Community Bancshares, Inc. Supplemental Directors Retirement Plan, as amended and restated	10.1	Form 8-K	12/16/2010	12/17/2010	
10.12.2**	Amendment #2 to the First Community Bancshares, Inc. Supplemental Directors Retirement Plan, as amended and restated	10.2	Form 8-K	5/24/2016	5/31/2016	
10.13**	Employment Agreement between First Community Bancshares, Inc. and David D. Brown	10.3	Form 8-K	4/16/2015	4/16/2015	
10.14**	Employment Agreement between First Community Bancshares, Inc. and E. Stephen Lilly	10.5	Form 8-K	4/16/2015	4/16/2015	
10.15**	Employment Agreement between First Community Bancshares, Inc. and Gary R. Mills	10.2	Form 8-K	4/16/2015	4/16/2015	
10.16**	Employment Agreement between First Community Bancshares, Inc. and William P. Stafford, II	10.1	Form 8-K	4/16/2015	4/16/2015	
10.17**	Employment Agreement between First Community Bank and Mark R. Evans	2.1	Form 8-K	4/2/2009	4/3/2009	
11	Statement Regarding Computation of Earnings per Share	Note 13 of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this report				
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101***	Interactive data files pursuant to Rule 405 of Regulation S-T					X

* Filed herewith

** Indicates a management contract or compensation plan or agreement
*** Submitted electronically herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 3rd day of August, 2018.

First Community Bancshares, Inc.

(Registrant)

/s/ William P. Stafford, II

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

/s/ David D. Brown

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