PURCHES FREDERICK E
Form 4
April 20, 2012

FORM 4

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

OMB APPROVAL	
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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
PURCHES FREDERICK E

(Last) (First) (Middle)

C/O PERFUMANIA HOLDINGS, INC., 35 SAWGRASS DRIVE, SUITE 2

(Street)

BELLPORT, NY 11713

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Perfumania Holdings, Inc. [PERF]

3. Date of Earliest Transaction (Month/Day/Year)
04/18/2012

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	04/18/2012		A		18,080	A	(1)	18,080	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)	
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares
Stock Option (Right to Buy)	$ 4.22	04/18/2012		A		13,333		04/18/2012	04/01/2015	Common Stock	13,333
Stock Option (Right to Buy)	$ 5.91	04/18/2012		A		26,666		04/18/2012	05/18/2016	Common Stock	26,666
Stock Option (Right to Buy)	$ 10.62	04/18/2012		A		26,666		04/18/2012	03/30/2017	Common Stock	26,666
Stock Option (Right to Buy)	$ 9.38	04/18/2012		A		10,000		(5)	04/18/2022	Common Stock	10,000

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
PURCHES FREDERICK E C/O PERFUMANIA HOLDINGS, INC. 35 SAWGRASS DRIVE, SUITE 2 BELLPORT, NY 11713	X			

Signatures

/s/ Donna L. Dellomo as attorney-in-fact	04/20/2012
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Received in exchange for 90,400 shares of Parlux Fragrances, Inc. ("Parlux") common stock pursuant to its acquisition by the issuer. On the effective date of the acquisition, the closing market price of Parlux's common stock was $5.78 per share and the closing market price

of the issuer's common stock was $9.38 per share.

(2) Received in exchange for a stock option to acquire 25,000 shares of Parlux common stock for $2.25 per share pursuant to the acquisition.

(3) Received in exchange for a stock option to acquire 50,000 shares of Parlux common stock for $3.15 per share pursuant to the acquisition.

(4) Received in exchange for a stock option to acquire 50,000 shares of Parlux common stock for $5.66 per share pursuant to the acquisition.

(5) The options vest in three (3) substantially equal installments beginning on the 1st anniversary of the grant and annually thereafter.

(6) Granted pursuant to the Perfumania 2010 Equity Incentive Plan

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	High	**Low**	**Book Value Per Share (End of Period)**	**Cash Dividends Per Share**	
2006					
First Quarter	$ 35.27	$ 30.16	$ 17.49	$ 0.26	
Second Quarter	33.00	29.50	17.71	0.26	
Third Quarter	34.44	30.04	18.40	0.26	
Fourth Quarter	41.17	31.67	18.92	0.26	$ 1.04
2005					
First Quarter	$ 36.21	$ 27.39	$ 16.35	$ 0.255	
Second Quarter	33.20	26.25	16.83	0.255	
Third Quarter	34.25	28.02	17.15	0.255	
Fourth Quarter	33.71	27.14	17.29	0.255	$ 1.02

The Company s stock repurchase plan, as amended, allows the purchase and retention of up to 550,000 shares. The plan has no expiration date, remains open and no plans have expired during the reporting period. No determination has been made to terminate the plan or to stop making purchases. The following table sets forth open market purchases by the Company of its equity securities during 2006. The repurchase of Company stock has the effect of increasing earnings per share. During 2006, the weighted-average increase in the number of treasury shares had an insignificant impact on earnings per share.

	Total Number of Shares	**Average Price Paid**	**Total Number of Shares Purchased as Part of**	**Maximum Number of Shares That May Yet Be Purchased**

	Purchased	per Share	Publicly Announced Plan	Under the Plan
January 1-31, 2006	23,161	$ 32.10	23,161	284,455
February 1-29, 2006	32,900	32.14	32,900	287,234
March 1-31, 2006	25,000	31.81	25,000	265,566
April 1-30, 2006	10,000	30.38	10,000	255,566
May 1-31, 2006	14,300	30.68	14,300	248,337
June 1-30, 2006	25,500	30.85	25,500	227,437
July 1-31, 2006	14,300	30.84	14,300	215,756
August 1-31, 2006				234,650
September 1-30, 2006				234,650
October 1-31, 2006				242,871
November 1-30, 2006				296,224
December 1-31, 2006				296,724
Total	145,161	$ 31.46	145,161	

In November 2006, the Company completed the acquisition of Investment Planning Consultants, Inc. (IPC), a registered investment advisory firm. In connection with the initial payment of approximately $1.47 million, the Company issued 39,874 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of IPC are entitled to additional consideration of $1.43 million in the form of the Company s common stock if certain future operating performance targets are met.

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Total Return Analysis

The following chart was compiled by SNL Securities, LC, and compares cumulative total shareholder return of the Company s Common Stock for the five-year period ended December 31, 2006, with the cumulative total return of the NASDAQ Composite index and the Asset Size & Regional Peer Group. The Asset Size & Regional Peer Group consists of 42 bank holding companies that are traded on the NASDAQ, OTC Bulletin Board, and pink sheets with total assets between $1 billion and $5 billion and are located in the southeast region of the United States. The cumulative returns include payment of dividends by the Company.

Total Return Performance

	Period Ending					
Index	**12/31/01**	**12/31/02**	**12/31/03**	**12/31/04**	**12/30/05**	**12/31/06**
First Community Bancshares, Inc.	100.00	118.64	144.89	162.66	145.22	190.26
NASDAQ Composite	100.00	68.76	103.67	113.16	115.57	127.58
Asset Size & Regional Peer Group	100.00	128.61	174.02	208.63	212.50	238.47

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ITEM 6. *SELECTED FINANCIAL DATA.*

Five-Year Selected Financial Data	2006	2005	2004	2003	2002
	At or for the Year Ended December 31, (Amounts in thousands)				
Balance Sheet Summary (at end of period)					
Securities(a)	$ 528,389	$ 428,554	$ 410,218	$ 473,177	$ 334,018
Loans held for sale	781	1,274	1,194	424	865
Loans, net of unearned income	1,284,863	1,331,039	1,238,756	1,026,191	927,621
Allowance for loan losses	14,549	14,736	16,339	14,624	14,410
Assets related to discontinued operations				22,372	71,631
Total assets	2,033,698	1,952,483	1,830,822	1,672,727	1,524,363
Deposits	1,394,771	1,403,220	1,356,719	1,223,376	1,137,816
Borrowings	406,556	335,885	274,212	242,267	156,823
Liabilities related to discontinued operations				17,992	65,519
Total liabilities	1,820,968	1,757,982	1,647,589	1,497,692	1,371,901
Stockholders equity	212,730	194,501	183,233	175,035	152,462
Summary of Earnings					
Total interest income	$ 120,026	$ 109,508	$ 96,136	$ 90,641	$ 92,580
Total interest expense	48,381	35,880	26,953	26,397	32,299
Provision for loan losses	2,706	3,706	2,671	3,419	4,208
Non-interest income	21,323	22,305	17,329	14,542	10,617
Non-interest expense	49,837	55,591	48,035	37,590	32,720
Income from continuing operations before income taxes	40,425	36,636	35,806	37,777	33,970
Income tax expense	11,477	10,191	9,786	11,058	9,740
Income from continuing operations	28,948	26,445	26,020	26,719	24,230
(Loss) income from discontinued operations before income taxes		(233)	(5,746)	(2,174)	798
Income tax (benefit) expense		(91)	(2,090)	(693)	309
(Loss) income from discontinued operations		(142)	(3,656)	(1,481)	489
Net income	28,948	26,303	22,364	25,238	24,719

(a) Reflects the reclassification during the 2002-2004 periods of Federal Reserve Bank and Federal Home Loan Bank stock from Securities Available for Sale to Other Assets, consistent with the 2005 and 2006 presentation.

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Five-Year Selected Financial Data	At or for the Year Ended December 31, 2006	2005	2004	2003	2002
Per Share Data					
Basic earnings per share	$ 2.58	$ 2.33	$ 1.99	$ 2.27	$ 2.26
Basic earnings per common share continuing operations	2.58	2.35	2.32	2.41	2.22
Basic (loss) earnings per common share discontinued operations		(0.02)	(0.33)	(0.14)	0.04
Diluted earnings per common share	$ 2.57	$ 2.32	$ 1.97	$ 2.25	$ 2.25
Diluted earnings per common share continuing operations	2.57	2.33	2.29	2.39	2.21
Diluted (loss) earnings per common share discontinued operations		(0.01)	(0.32)	(0.14)	0.04
Cash dividends	$ 1.04	$ 1.02	$ 1.00	$ 0.98	$ 0.91
Book value at year-end	$ 18.92	$ 17.29	$ 16.29	$ 15.57	$ 14.02
Selected Ratios					
Return on average assets	1.46%	1.37%	1.24%	1.56%	1.68%
Return on average assets-continuing	1.46%	1.38%	1.45%	1.70%	1.72%
Return on average equity	14.32%	13.79%	12.53%	15.13%	17.16%
Return on average equity-continuing	14.32%	13.87%	14.58%	16.02%	16.82%
Average equity to average assets	10.21%	9.91%	9.88%	10.32%	9.79%
Average equity to average assets-continuing	10.21%	9.91%	9.96%	10.64%	10.22%
Dividend payout	40.31%	43.78%	50.25%	43.17%	40.16%
Risk based capital to risk adjusted assets	12.69%	11.65%	12.09%	14.55%	13.33%
Leverage ratio	8.50%	7.77%	7.62%	8.83%	8.10%

ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.*

This discussion should be read in conjunction with the consolidated financial statements, notes and tables included throughout this report. All statements other than statements of historical fact included in this report, including statements in this Management s Discussion and Analysis of Financial Condition and Results of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act. As discussed below, the financial statements, footnotes, schedules and discussion within this report have been reformatted to conform to the presentation required for discontinued operations pursuant to the Company s sale of its mortgage banking subsidiary.

Executive Overview

First Community Bancshares, Inc. is a bank holding company which provides commercial banking services and has positioned itself as a regional community bank and a financial services alternative to larger banks which often provide less emphasis on personal relationships, and smaller community banks which lack the capital and resources to efficiently serve customer needs. The Company has focused its growth efforts on building financial partnerships and more enduring and complete relationships with businesses and individuals through a very personal approach to banking and financial services. The Company and its operations are guided by a strategic plan which includes growth through acquisitions and through office expansion in new market areas including strategically identified metro

markets in Virginia, West Virginia, North Carolina and Tennessee. While the Company s mission remains that of a community bank, management believes that entry into new markets will accelerate the Company s growth rate by diversifying the demographics of its customer base and customer prospects and by generally increasing its sales and service network.

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Economy

Throughout 2006, short-term market interest rates increased, while long-term market rates remained largely unchanged. Those changes have resulted in an inverted interest rate curve, an environment that has led to increased compression of net interest margins.

The local economies in which the Company operates are diverse and cover the majority portion of a four state region. West Virginia and Southwest Virginia continue to benefit from increasing crude oil prices. These economies have significant exposure to extractive industries, such as coal and natural gas, which become more active and lucrative when oil prices rise. The local economies in the central portion of North Carolina have suffered in recent years due to foreign competition in both furniture and textiles as well as consolidation in the financial services industry. Despite these detractions, the economies in this region continue to benefit from strong real estate development, good commercial occupancy rates and national companies relocating and expanding in the Triad and Central Piedmont areas. The Eastern Virginia local economies are experiencing strong growth in residential and commercial development as those areas continue to benefit from a wide array of corporate activities and relocations.

Competitive Focus

As the Company competes for increased market share and growth in both loans and deposits it continues to encounter strong competition from many sources. Bank expansion through de novo branches and loan production offices has grown in popularity as a means of reaching out to new markets. Many of the markets targeted by the Company are also being entered by other banks in nearby markets and, in some cases, from more distant markets. Despite strong competition from other banks, credit unions and mortgage companies, the Company has seen success in newly established offices in Winston-Salem as well as other markets in both Virginia and North Carolina. The Company attributes this measure of success to its recruitment of local, established bankers and loan personnel in those targeted markets. Competitive forces do impact the Company through pressure on interest yields, product fees and loan structure and terms; however, the Company has countered these pressures with its relationship style and pricing and a disciplined approach to loan underwriting.

Application of Critical Accounting Policies

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

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

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

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Allowance for Loan Losses

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

The Company determines the allowance for loan losses by making specific allocations to impaired loans that exhibit inherent weaknesses and various credit risk factors. General allocations to commercial, residential real estate, and consumer loan pools are developed giving weight to risk ratings, historical loss trends and management s judgment concerning those trends and other relevant factors. These factors may include, among others, actual versus estimated losses, regional and national economic conditions, business segment and portfolio concentrations, industry competition and consolidation, and the impact of government regulations. The foregoing analysis is performed by management to evaluate the portfolio and calculate an estimated valuation allowance through a quantitative and qualitative analysis that applies risk factors to those identified risk areas.

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

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

Acquisitions and Intangible Assets

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

Management must also make estimates of useful or economic lives of certain acquired assets and liabilities. These lives are used in establishing amortization and accretion of some intangible assets and liabilities, such as the intangible

associated with core deposits acquired in the acquisition of a commercial bank.

Goodwill is recorded as the excess of the purchase price, if any, over the fair value of the revalued net assets. Goodwill is tested annually in the month of November for possible impairment by comparing the fair value of the unit with its book value, including goodwill. If the fair value of the Company is greater than its book value, no goodwill impairment exists. However, if the book value of the Company is greater than its determined fair value, goodwill impairment may exist and further testing is required to determine the amount, if any, of the actual impairment loss. Further testing would use a discounted cash flow model applied to the anticipated stream of cash

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flows from operations of the business or segment being tested. Impairment testing necessarily uses estimates in the form of growth and attrition rates, anticipated rates of return, and discount rates. These estimates have a direct bearing on the results of the impairment testing and serve as the basis for management s conclusions as to impairment.

Income Taxes

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

Recent Acquisitions and Branching Activity

In December 2006, the Company completed the sale of its Rowlesburg, West Virginia, branch location. At the time of the sale, the branch had deposits and repurchase agreements totaling approximately $10.6 million and loans of approximately $2.2 million. The transaction resulted in a pre-tax gain of approximately $333 thousand.

In November 2006, the Company completed the acquisition of Investment Planning Consultants, Inc. (IPC), a registered investment advisory firm. In connection with the initial payment of approximately $1.47 million, the Company issued 39,874 shares of common stock. Under the terms of the stock purchase agreement, former shareholders of IPC are entitled to additional consideration of $1.43 million in the form of the Company s common stock if certain future operating performance targets are met. If those operating targets are met, the value of the consideration ultimately paid will be added to the cost of the acquisition, which will increase the amount of goodwill related to the acquisition.

In June 2006, the Company completed the sale of its Drakes Branch, Virginia, branch location. At the time of the sale, the branch had deposits and repurchase agreements totaling approximately $16.4 million and loans of approximately $1.9 million. The transaction resulted in a pre-tax gain of approximately $702 thousand.

In December 2005, the Company completed the sale of its Clifton Forge, Virginia, branch location. The sale included deposits and repurchase agreements totaling approximately $45.3 million and loans of approximately $7.1 million. The transaction resulted in an approximate $4.4 million pre-tax gain on sale.

The Company has plans to open two new branches in Winston-Salem, North Carolina, during the first quarter of 2007. Construction is also under way on branches in Mechanicsville, Virginia, and Daniels and Summersville, West Virginia. Those three branches are expected to be open by the fourth quarter of 2007.

RESULTS OF OPERATIONS

2006 COMPARED TO 2005

Net income for 2006 was $28.9 million, up $2.6 million from $26.3 million in 2005. Basic and diluted earnings per share for 2006 were $2.58 and $2.57, respectively, compared to basic and diluted earnings per share of $2.33 and $2.32, respectively, in 2005.

The Company s key profitability ratios are return on average assets and return on average equity. Returns on average assets for 2006 and 2005 were 1.46% and 1.37%, respectively. The returns on average equity for 2006 and 2005 were 14.32% and 13.79%, respectively. The Company continues to compare favorably to national peer returns of 1.13% and 13.20%, respectively, based on the September 2006 Bank Holding Company Performance Report, prepared by the Federal Reserve.

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Net Interest Income

The primary source of the Company s earnings is net interest income, the difference between income on earning assets and the cost of funds supporting those assets. Significant categories of earning assets are loans and securities while deposits and borrowings represent the major portion of interest-bearing liabilities. For purposes of the following discussion, comparison of net interest income is performed on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those assets which are fully taxable (see the table titled Average Balance Sheets and Net Interest Income Analysis).

Net interest income was $71.6 million for 2006, compared to $73.6 million for 2005. Tax-equivalent net interest income totaled $75.7 million for 2006, a decrease of $2.0 million from the $77.7 million reported for 2005. The decrease is attributable to a $651 thousand decrease due to volume and a $1.4 million decrease due to rate changes on the underlying assets and liabilities.

During 2006, average earning assets increased $23.8 million while average interest-bearing liabilities increased $35.9 million, in each case over the comparable period. The yield on average earning assets increased 50 basis points to 6.92% from 6.42% for 2005. The rate earned on assets was positively impacted by the continued increases in short-term market interest rates throughout 2006.

Total cost of average interest-bearing liabilities increased 76 basis points to 3.17% during 2006, as liabilities were also affected by increases in short-term market interest rates. The net result was a decrease of 26 basis points to net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities. Spread for 2006 was 3.75% compared to 4.01% for 2005. The Company s tax-equivalent net interest margin of 4.22% for 2006 was a decrease of 17 basis points from 4.39% in 2005.

The largest contributor to the increase in the yield on average earning assets in 2006, on a volume-weighted basis, was a 50 basis point increase in the rate earned on loans held for investment. The increase in rate contributed approximately $6.5 million to the $7.5 million change in interest income from the portfolio. The yield on variable-rate loans tied to prime and other indices increased in response to the recent increases in short-term interest rates.

During 2006, the tax-equivalent yield on available for-sale securities increased 52 basis points to 5.50% while the average balance increased by $21.6 million. The average tax-equivalent yield increased due to the addition of higher-rate securities and the sales, maturities, and calls of lower-rate securities.

Average interest-bearing balances with banks declined $4.8 million during 2006 to $27.3 million, while the yield increased 120 basis points to 4.56%. The yield on those balances is directly correlated to the increases in the target federal funds rate which occurred throughout the year.

The Company attempts to control the cost of deposited funds in relation to the prevailing economic climate and competitive forces. The Company determines its overall balance sheet management goals through its Asset/Liability Management Committee. Throughout 2006, the pressures of increasing short-term interest rates resulted in an increase of 86 basis points in the average cost of interest-bearing deposits. The average rate paid on interest-bearing demand deposits increased 6 basis points, while the average rate paid on savings, which includes money market and passbook accounts, increased 82 basis points. The Company was successful in keeping rates paid on interest-bearing checking accounts relatively stable and increased money market account rates to remain competitive and retain deposit funding. Average time deposits increased $21.9 million while the average rate paid increased 96 basis points to 3.88%. The level of average non-interest-bearing demand deposits increased $8.9 million to $237.7 million compared to the prior year.

Average federal funds purchased and repurchase agreements increased $22.3 million, due mostly to increases in the balances of repurchase agreements. The average rate paid on those funds also increased, as they are closely tied to the target federal funds rate. Average Federal Home Loan Bank (FHLB) advances increased $22.7 million while interest paid on those borrowings decreased 56 basis points as the Company repositioned its FHLB borrowings, and took advantage of lower interest rate borrowing products. In January of 2006, the Company borrowed $75 million from the FHLB. At the same time, the Company entered into a $50 million pay fixed, receive variable interest rate swap, effectively fixing the borrowing rate at approximately 4.34%. Other borrowings

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remained steady, but the rate paid increased 176 basis points because the majority of such borrowings consist of the Company s trust preferred borrowing, which is tied to LIBOR.

Average Balance Sheets and Net Interest Income Analysis

	2006			2005			2004	
	Average Balance	Interest(1)	Yield/ Rate(1)	Average Balance	Interest(1)	Yield/ Rate(1)	Average Balance	Interest(1)
				(Dollars in thousands)				
Assets:								
eld for Investment:(2)								
	$ 1,314,976	$ 97,386	7.41%	$ 1,299,328	$ 89,788	6.91%	$ 1,154,166	$ 76,519
mpt	1,499	114	7.61%	2,692	177	6.58%	4,965	297
	1,316,475	97,500	7.41%	1,302,020	89,965	6.91%	1,159,131	76,816
e-for-Sale Securities:								
	276,142	13,929	5.04%	262,715	11,062	4.21%	313,033	12,094
mpt	152,437	9,655	6.33%	144,242	9,193	6.37%	110,904	7,474
	428,579	23,584	5.50%	406,957	20,255	4.98%	423,937	19,568
Maturity Securities:								
	386	22	5.70%	399	15	3.76%	419	25
mpt	20,912	1,686	8.06%	28,336	2,269	8.01%	35,535	2,853
	21,298	1,708	8.02%	28,735	2,284	7.95%	35,954	2,878
bearing deposits with	27,289	1,244	4.56%	32,100	1,077	3.36%	32,430	591
funds sold							60	1
rning assets	1,793,641	$ 124,036	6.92%	1,769,812	$ 113,581	6.42%	1,651,512	$ 99,854
sets	186,639			153,410			140,379	
elated to discontinued ns							14,950	
	$ 1,980,280			$ 1,923,222			$ 1,806,841	
bearing Liabilities:								
deposits	$ 146,248	$ 462	0.32%	$ 152,774	$ 401	0.26%	$ 149,502	$ 366
deposits	343,854	6,857	1.99%	368,339	4,309	1.17%	366,074	3,112
posits	683,418	26,549	3.88%	661,498	19,321	2.92%	615,346	15,001
funds purchased and se agreements	150,839	5,079	3.37%	128,551	2,782	2.16%	109,223	1,405
rrowings and other n debt	200,570	9,434	4.70%	177,832	9,068	5.10%	148,384	7,070
erest-bearing es	1,524,929	48,381	3.17%	1,488,994	35,881	2.41%	1,388,529	26,954
deposits	237,714			228,781			212,777	

bilities	15,513	14,772	13,980
es related to ued operations			13,113
ders equity	202,124	190,675	178,442
	$ 1,980,280	$ 1,923,222	$ 1,806,841
est Income	$ 75,655	$ 77,700	$ 72,900
est Rate Spread(3)	3.75%	4.01%	
est Margin(4)	4.22%	4.39%	

(1) Fully taxable equivalent at the rate of 35%.

(2) Non-accrual loans are included in average balances outstanding but with no related interest income during the period of non-accrual.

(3) Represents the difference between the yield on earning assets and cost of funds.

(4) Represents tax equivalent net interest income divided by average interest-earning assets.

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Rate and Volume Analysis of Interest

The following table summarizes the changes in interest earned and paid resulting from changes in volume of earning assets and paying liabilities and changes in their interest rates. In this analysis, the change in interest due to both rate and volume has been allocated to the volume and rate columns in proportion to absolute dollar amounts. The table shows (i) the overall decrease in net interest income during 2006 was due to increases in interest expense which outpaced increases in interest income; and (ii) increases in rates earned on assets and paid on liabilities continued to increase in 2006, due primarily to continuing increases in benchmark short-term interest rates. When comparing 2005 to 2004, the table shows (i) the increase in net interest income in 2005 was due largely to increases in earning assets resulting from growth seen in both the consumer and commercial loan portfolios; (ii) increases in both rates earned on assets and paid on liabilities due to increases in benchmark short-term interest rates; and (iii) in 2005, margin compressed slightly as increases to the rates paid on money market accounts and certificates of deposit outpaced increases in the rates received on loans.

	2006 Compared to 2005 $ Increase/(Decrease) due to			2005 Compared to 2004 $ Increase/(Decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Amounts in thousands)					
Interest Earned On(1):						
Loans	$ 1,005	$ 6,530	$ 7,535	$ 9,782	$ 3,367	$ 13,149
Securities available for sale	1,108	2,221	3,329	87	600	687
Securities held to maturity	(599)	23	(576)	(578)	(16)	(594)
Interest-bearing deposits with other banks	(178)	345	167	(6)	492	486
Federal funds sold				(1)		(1)
Total interest-earning assets	1,336	9,119	10,455	9,284	4,443	13,727
Interest Paid On:						
Demand deposits	(18)	79	61	8	27	35
Savings deposits	(304)	2,852	2,548	19	1,178	1,197
Time deposits	660	6,568	7,228	1,186	3,134	4,320
Federal funds purchased and repurchase agreements	546	1,751	2,297	284	1,093	1,377
FHLB borrowings and other long-term debt	1,103	(737)	366	1,443	555	1,998
Total interest-bearing liabilities	1,987	10,513	12,500	2,940	5,987	8,927
Change in net interest income	$ (651)	$ (1,394)	$ (2,045)	$ 6,344	$ (1,544)	$ 4,800

(1) Fully taxable equivalent using a rate of 35%.

Provision for Loan Losses

The provision for loan losses for 2006 was $2.7 million, a decrease of $1.0 million when compared to 2005. The decrease in loan loss provision between the periods is primarily attributable to changes in specific allocations, decreases in commercial and consumer installment loan volume, reductions in net charge-offs, overall improved asset quality, and changes in various qualitative risk factors. Net charge-offs for 2006 and 2005 were $2.9 million and $4.9 million, respectively. Expressed as a percentage of average loans, net charge-offs decreased from 0.38% for 2005 to 0.22% for 2006. During 2005, the Company experienced a loss from a credit to a hospitality concern, which largely accounted for the higher net charge-offs in 2005. The $4.4 million loan was charged down to its net realizable value of $2.2 million, and the note was sold to a third party and the final net loss to the Company was $1.5 million.

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Non-interest Income

Details of non-interest income are summarized in the following table:

	Years Ended December 31,		
	2006	2005	2004
	(Amounts in thousands)		
Wealth management income	$ 2,811	$ 2,956	$ 2,489
Service charges on deposit accounts	10,242	10,095	9,122
Other service charges, commissions and fees	2,992	2,785	2,239
Other operating income	5,203	5,716	1,875
Net gains on sale of securities	75	753	1,604
Total	$ 21,323	$ 22,305	$ 17,329

Non-interest income consists of all revenues which are not included in interest and fee income related to earning assets. Non-interest income for 2006 was $21.3 million compared to $22.3 million in 2005. Wealth management income, which includes fees for trust services and commission and fee income generated by IPC (post-acquisition) and the Company s prior investment advisory subsidiary, whose customer base migrated to IPC in 2006, decreased $145 thousand in 2006, or 4.9%, compared to 2005.

Service charges on deposit accounts increased $147 thousand, or 1.5%, while other service charges, commissions and fees reflected gains of $207 thousand, or 7.4%.

Other operating income includes $1.0 million and $4.4 million in gains from the sale of branch locations in 2006 and 2005, respectively. The remaining components of other operating income increased $2.8 million compared to 2005. The largest single item in that increase is the $976 thousand earned on the Company s $25 million investment in life insurance made in April 2006. Also included in other income for 2006 is a $676 thousand recovery relating to a 1997 payment system fraud loss. During 2006, the Company also recognized securities gains of $75 thousand, which were $678 thousand less than those recognized in 2005.

Non-interest Expense

Total non-interest expense was $49.8 million for 2006, a decrease of $5.8 million over 2005. Salaries and benefits decreased approximately $2.6 million due to the Company s refocused efforts on expense control and efficiency. During 2006, total full-time equivalent employees decreased to 602 from 716 at December 31, 2005. Also contributing to the decrease from year to year was the $3.8 million prepayment penalty incurred in connection with the early termination of $77.0 million of FHLB advances in 2005.

Occupancy and furniture and equipment expenses increased $165 thousand and $147 thousand, respectively, compared to 2005. The general level of occupancy and furniture and equipment costs in 2006 grew largely as a result of increases in depreciation associated with continued investment in facilities, operating equipment, and technology infrastructure.

All other operating expense accounts increased $367 thousand, or less than 3%, in 2006 compared to 2005.

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

In general, the efficiency ratio used by the Company is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation exclude amortization of goodwill and intangibles and non-recurring expenses. Income for the ratio is increased for the favorable effect of tax-exempt income (see Average Balance Sheets and Net Interest Income Analysis), and excludes securities gains and losses,

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which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP-based efficiency ratio, which also is presented in this report, which is calculated using non-interest expense and income amounts as shown on the face of the Consolidated Statements of Income. Both types of efficiency ratio calculations are set forth and are reconciled in the table below.

Our (non-GAAP) efficiency ratios for continuing operations for 2006, 2005, and 2004 were 51.1%, 53.8%, and 53.2%, respectively. The following table details the components used in calculation of the efficiency ratios.

GAAP-based and Our Efficiency Ratios

	2006	2005	2004
	(Dollars in thousands)		
GAAP-based efficiency ratio			
Non-interest expenses	$ 49,837	$ 55,591	$ 48,035
Net interest income plus non-interest income	92,968	95,933	86,512
Efficiency ratio GAAP-based	53.61%	57.95%	55.52%
Our efficiency ratio			
Non-interest expenses GAAP-based	$ 49,837	$ 55,591	$ 48,035
Less non-GAAP adjustments:			
Foreclosed property expense	(248)	(288)	(500)
Amortization of intangibles	(410)	(435)	(399)
Prepayment penalties on FHLB advances		(3,794)	
Other non-core, non-recurring expense items	(581)		
Adjusted non-interest expenses	48,598	51,074	47,136
Net interest income plus non-interest income GAAP-based	92,968	95,933	86,512
Plus non-GAAP adjustment:			
Tax-equivalency	4,010	4,072	3,719
Less non-GAAP adjustments:			
Security gains	(75)	(753)	(1,604)
Branch sale gains	(1,035)	(4,366)	
Other non-core, non-recurring income items	(676)		
Adjusted net interest income plus non-interest income	95,192	94,886	88,627
Our efficiency ratio	51.05%	53.83%	53.18%

Equity-based Compensation

On January 1, 2006, the Company adopted the equity-based compensation accounting provisions of Statement of Financial Accounting Standards (SFAS) 123R. Through December 31, 2005, the Company accounted for equity-based compensation under APB Opinion No. 25, using the intrinsic value model. Under Opinion No. 25, the Company recognized no compensation expense related to stock options granted, and provided pro-forma disclosures of the effects of accounting for stock options under the fair value model. The Company selected the modified

prospective method of transition. The adoption of the new equity-based compensation accounting standard resulted in increased compensation expense. The total compensation cost related to stock option awards vesting in 2006 was approximately $208 thousand after-tax.

Income Tax Expense

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are

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commonly referred to as permanent differences. The most significant permanent differences for the Company include income on state and municipal securities which are exempt from federal income tax, certain dividend payments which are deductible by the Company, tax credits generated by investments in low income housing and historical building rehabilitation.

Consolidated income taxes for 2006 were $11.5 million, a 28.4% effective tax rate, compared to $10.1 million, an effective tax rate of 27.7%, for 2005. The effective tax rate for 2006 was greater than 2005 due to a lower proportion of tax-free municipal interest income.

As disclosed in previous filings, the state tax audit of state income, franchise, and sales tax in one of the Company s tax jurisdictions was concluded during the fourth quarter of 2005. The outcome of this audit was favorable to the Company and resulted in total state income and franchise tax refunds of approximately $473 thousand, which was reflected in the 2005 provision for income tax expense.

2005 COMPARED TO 2004

Net income for 2005 was $26.3 million, up $3.9 million from $22.4 million in 2004. Basic and diluted earnings per share for 2005 were $2.33 and $2.32, respectively, compared to basic and diluted earnings per share of $1.99 and $1.97, respectively, for 2004. Return on average assets for 2005 and 2004 were 1.37% and 1.24%, respectively. The return on average equity for 2005 and 2004 were 13.79% and 12.53%, respectively. The Company compared favorably to national peer returns of 1.16% and 13.51%, respectively, based on the September 2005 Bank Holding Company Performance Report.

Net Interest Income

The primary source of the Company s earnings is net interest income, the difference between income on earning assets and the cost of funds supporting those assets. Significant categories of earning assets are loans and securities while deposits and borrowings represent the major portion of interest-bearing liabilities. For purposes of the following discussion, comparison of net interest income is done on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those assets which are fully taxable (see the table titled Average Balance Sheets and Net Interest Income Analysis).

Net interest income was $73.6 million for 2005, compared to $69.2 million for 2004. Tax-equivalent net interest income totaled $77.7 million for 2005, an increase of $4.8 million from the $72.9 million reported for 2004. The increase reflects a $6.3 million increase due to increased volume, which was partially offset by a $1.5 million decrease due to rate changes on the underlying assets and liabilities.

During 2005, average earning assets increased $118.3 million while average interest-bearing liabilities increased $100.5 million over the comparable period. The yield on average earning assets increased 37 basis points to 6.42% from 6.05% for 2004. The rate earned on assets was positively impacted by the continued increases in short-term market interest rates throughout 2005.

Total cost of average interest-bearing liabilities increased 47 basis points during 2005, as such liabilities were also affected by increases in short-term market interest rates. The net result was a decrease of 10 basis points to net interest rate spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities. 2005 spread was 4.01% compared to 4.11% for 2004. The Company s tax-equivalent net interest margin of 4.39% for 2005 was essentially unchanged with a small decrease of 2 basis points from 4.41% in 2004.

The largest contributor to the increase in the yield on average earning assets in 2005, on a volume-weighted basis, was the $142.9 million increase in loans held for investment. The loan portfolio contributed approximately $13.1 million to the change in interest income, while the portfolio s average yield increased 28 basis points from the prior year to 6.91%. The yield on variable-rate loans tied to prime and other indices increased in response to the recent increases in short-term interest rates.

During 2005, the tax-equivalent yield on available-for-sale securities increased 36 basis points to 4.98% while the average balance decreased by $17.0 million. Although the total portfolio decreased through the period, the average tax-equivalent yield increased due to the addition of higher-rate securities and the sale of lower-rate

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securities. Funds received from the paydowns, maturities, calls, and sales of investment securities helped fund loan growth.

Average interest-bearing balances with banks remained steady during 2005, while the yield increased 154 basis points to 3.36%. The yield on those balances is directly correlated to the increases in the target federal funds rate which occurred throughout the year.

The Company attempts to control the cost of deposited funds in relation to the prevailing economic climate and competitive forces. The Company determines its balance sheet management goals through its Asset/Liability Management Committee. Throughout 2005, the pressures of increasing short-term interest rates resulted in an increase of 40 basis points in the average cost of interest-bearing deposits. The average rate paid on interest-bearing demand deposits remained consistent, while the average rate paid on savings, which includes money market and passbook accounts, increased 32 basis points. The Company was successful in keeping rates paid on interest-bearing checking accounts relatively stable and increased money market account rates to remain competitive. Average time deposits increased $46.2 million while the average rate paid increased 48 basis points to 2.92%. The level of average non-interest-bearing demand deposits increased $16.0 million to $228.8 million compared to the prior year.

Average federal funds purchased and repurchase agreements increased $19.3 million due mostly to increases in the balances of customer repurchase agreements. The average rate paid on those funds also increased, as they are closely tied to the target federal funds rate. Average Federal Home Loan Bank (FHLB) advances increased $29.5 million as the Company borrowed $75 million through the year. Interest paid on those borrowings increased 19 basis points as interest rates were increasing on adjustable-rate borrowings. Other borrowings remained steady, but the rate paid increased 198 points because the majority of such borrowings consist of the Company s trust preferred borrowing, which is tied to LIBOR.

Non-interest Income

Non-interest income consists of all revenues which are not included in interest and fee income related to earning assets. Non-interest income from continuing operations for 2005 was $22.3 million compared to $17.3 million 2004. Wealth management income, which includes fees for trust services and commission and fee income generated by Stone Capital, the Company s prior investment advisory subsidiary, increased $467 thousand in 2005, or 18.8%, compared to 2004 as a result of the Company s continued focus on growth. Stone Capital expanded its retail asset management services through the addition of two investment advisors and the licensing of a number of investment associates within the bank branches.

Service charges on deposit accounts increased $973 thousand, or 10.7%, while other service charges, commissions and fees reflected gains of $546 thousand, or 24.4%. Other service charges, commissions and fees increased largely because of ATM usage fees on foreign cards which totaled $1.4 million and official check commissions which reached $256 thousand.

Other operating income includes $4.4 million in gain from the sale of the Clifton Forge, Virginia, branch location in December 2005. The remaining components of other operating income decreased $525 thousand compared to 2004. During 2005, other operating income included securities gains of $753 thousand, which were $851 thousand less than those recognized in 2004.

Non-interest Expense

Total non-interest expense from continuing operations was $55.6 million, an increase of $7.6 million for 2005 over 2004. The single largest item contributing to the increase was a $3.8 million prepayment penalty incurred in

connection with the early termination of $77.0 million of FHLB advances in late December 2005. Salaries and benefits increased approximately $2.8 million due to increases in staffing to support added corporate services, continued branch and loan production office growth, and increased health benefits costs.

Occupancy and furniture and equipment expenses increased $344 thousand and $447 thousand in 2005, respectively, compared to 2004. The general level of occupancy and furniture and equipment costs in 2005 grew

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largely as a result of increases in depreciation and insurance costs associated with de novo branches and depreciation associated with continued investment in operating equipment and technology infrastructure.

All other operating expense accounts increased $100 thousand in 2005 compared to 2004. The most significant item within the increase in other operating expense was the increase in audit fees, which increased over $335 thousand year-over-year.

Income Tax Expense

Income tax expense is comprised of federal and state current and deferred income taxes on pre-tax earnings of the Company. Income taxes as a percentage of pre-tax income may vary significantly from statutory rates due to items of income and expense which are excluded, by law, from the calculation of taxable income. These items are commonly referred to as permanent differences. The most significant permanent differences for the Company include i) income on state and municipal securities which are exempt from federal income tax, ii) certain dividend payments which are deductible by the Company, iii) tax credits generated by investments in low income housing and iv) for 2004, goodwill impairment expense which is not deductible.

Consolidated income taxes for 2005 were $10.1 million, a 27.7% effective tax rate, compared to $7.7 million, an effective tax rate of 25.6%, for 2004. The effective tax rate for 2004 was less than 2005 due to the tax benefits realized from the divestiture of the Company s mortgage banking subsidiary. Specifically, the non-deductible impairment charges recognized in 2003 and the first two quarters of 2004 reduced the book carrying basis of the investment in the mortgage subsidiary and resulted in a permanent difference during the third quarter of 2004 upon sale of the entity. This difference reduced the 2004 effective tax rate to 25.6% and is the primary cause of the increase in the effective tax rate when comparing 2004 to 2005.

FINANCIAL POSITION

Available-for-Sale Securities

Available-for-sale securities were $508.4 million at December 31, 2006, compared to $404.4 million at December 31, 2005, an increase of $104.0 million. The Company purchased securities throughout the year with liquidity provided by net loan portfolio payoffs, and executed two leverage transactions totaling $50 million during 2006.

The Company attempts to maintain an acceptable level of interest rate risk within its securities portfolio. At December 31, 2006, the average life and duration of the portfolio were 7.1 years and 5.4, respectively. Average life and duration remained relatively unchanged from December 31, 2005, at 7.0 years and 5.4, respectively.

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, the expectation for that security s performance, the creditworthiness of the issuer and the Company s intent and ability to hold the security to recovery or maturity. A decline in value that is considered to be other-than-temporary would be recorded as a loss within non-interest income in the Consolidated Statements of Income. The Company does not believe any unrealized loss, individually or in the aggregate, as of December 31, 2006, represents other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature. Furthermore, the Company believes the decline in value is attributable to changes in market interest rates and not the credit quality of the issuer.

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The following table details amortized cost and fair value of available-for-sale securities as of December 31, 2006, 2005, and 2004.

	December 31,					
	2006		2005		2004	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Amounts in thousands)					
U.S. Government agency securities	$ 117,777	$ 116,061	$ 92,739	$ 91,424	$ 46,541	$ 45,946
States and political subdivisions	152,189	154,047	151,118	152,168	142,882	145,146
Corporate Notes	85,080	85,033	61,466	61,274	37,589	38,129
	355,046	355,141	305,323	304,866	227,012	229,221
Mortgage-backed securities	146,444	144,754	94,954	92,994	142,427	142,979
Equities	6,933	8,475	5,390	6,521	2,626	3,797
Total	$ 508,423	$ 508,370	$ 405,667	$ 404,381	$ 372,065	$ 375,997

Held-to-Maturity Securities

Investment securities classified as held-to-maturity are comprised primarily of high-grade state and municipal bonds. These securities generally carry AAA bond ratings, most of which also carry credit enhancement insurance by major insurers of debt instruments. The portfolio totaled $20.0 million at December 31, 2006, compared to $24.2 million at December 31, 2005. This decrease is reflective of continuing paydowns, maturities and calls within the portfolio. The market value of held-to-maturity investment securities was 101.7% and 102.9% of book value at December 31, 2006 and 2005, respectively. Recent trends in interest rates have had little effect on the portfolio market value since December 31, 2005, due to its larger percentage of municipal securities which display less price sensitivity to rate changes.

The average final maturity of the held-to-maturity investment portfolio decreased from 6.6 years at December 31, 2005, to 6.1 years at December 31, 2006, with the tax-equivalent yield increasing from 7.95% at year-end 2005 to 8.02% at the close of 2006. The weighted-average expected maturity of the investment portfolio, based on market assumptions for prepayment, is ten months and 1.6 years at December 2006 and 2005, respectively. The average maturity data differs from final maturity data because of the use of assumptions as to anticipated prepayments, and is generally a more accurate indicator of true average life of the investment.

The following table details amortized cost and fair value of held-to-maturity securities for the three years ended December 31, 2006.

	December 31,					
	2006		2005		2004	
	Amortized	Fair	Amortized	Fair	Amortized	Fair

	Cost	Value	Cost	Value	Cost	Value
			(Amounts in thousands)			
States and political subdivisions	$ 19,638	$ 19,970	$ 23,781	$ 24,486	$ 33,814	$ 35,202
Corporate Notes	375	374	375	374	375	375
	20,013	20,344	24,156	24,860	34,189	35,577
Mortgage-backed securities	6	6	17	17	32	33
Total	$ 20,019	$ 20,350	$ 24,173	$ 24,877	$ 34,221	$ 35,610

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Loans Held for Sale

To mitigate interest rate risk, the Company sells most of the long-term, fixed-rate mortgage loans it originates in the secondary market. At December 31, 2006, the Company held $781 thousand of loans for sale to the secondary market, down from $1.3 million at December 31, 2005. The gross notional amount of outstanding commitments to originate mortgage loans for customers at December 31, 2006, was $6.6 million on 49 loans.

Loans Held for Investment

Total loans held for investment decreased $46.2 million to $1.28 billion at December 31, 2006, from $1.33 billion at December 31, 2005, as a result of decreased loan production and large payoffs occurring throughout 2006. The average loan to deposit ratio increased to 93.3% for 2006, compared with 92.3% for 2005. Average loans held for investment for 2006 of $1.32 billion increased $14.5 million when compared to the average for 2005 of $1.30 billion.

The held for investment loan portfolio continues to be diversified among loan types and industry segments. The following table presents the various loan categories and changes in composition at year-end 2002 through 2006.

Loan Portfolio Summary

	December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Amounts in thousands)				
Commercial, financial and agricultural	$ 106,645	$ 110,211	$ 99,302	$ 69,395	$ 74,186
Real estate commercial	421,067	464,510	453,899	317,421	285,847
Real estate construction	158,566	143,976	112,705	98,510	72,275
Real estate residential	506,370	504,387	457,417	421,299	364,087
Consumer	88,679	106,206	113,639	119,195	131,385
Other	3,549	1,808	2,012	992	726
Total	1,284,876	1,331,098	1,238,974	1,026,812	928,506
Less unearned income	13	59	218	621	885
	1,284,863	1,331,039	1,238,756	1,026,191	927,621
Less allowance for loan losses	14,549	14,736	16,339	14,624	14,410
Net loans	$ 1,270,314	$ 1,316,303	$ 1,222,417	$ 1,011,567	$ 913,211

The Company maintained no foreign loans in the periods presented. Although the Company s loans are made primarily in the four-state region in which it operates, the Company had no concentrations of loans to one borrower or industry representing 10% or more of outstanding loans at December 31, 2006.

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The following table details the maturities and rate sensitivity of the Company s loan portfolio at December 31, 2006.

	Remaining Maturities				
	One Year and Less	**Over One to Five Years**	**Over Five Years**	**Total**	**Percent**
	(Amounts in thousands)				
Commercial, financial and agricultural	$ 53,476	$ 49,592	$ 3,577	$ 106,645	8.30%
Real estate commercial	82,588	253,902	84,577	421,067	32.77%
Real estate construction	113,219	40,258	5,089	158,566	12.34%
Real estate mortgage	44,107	161,437	300,826	506,370	39.41%
Consumer	15,986	66,967	5,726	88,679	6.90%
Other	1,251	2,111	187	3,549	0.28%
	$ 310,627	$ 574,267	$ 399,982	$ 1,284,876	100.00%
Rate Sensitivity:					
Pre-determined rate	$ 125,257	$ 456,522	$ 81,833	$ 663,612	51.65%
Floating- or adjustable-rate	185,370	117,745	318,149	621,264	48.35%
	$ 310,627	$ 574,267	$ 399,982	$ 1,284,876	100.00%

Allowance for Loan Losses

The allowance is increased by charges to earnings in the form of provisions and by recoveries of prior charge-offs, and decreased by charge-offs. The provisions are calculated to bring the allowance to a level, which, according to a systematic process of measurement, is reflective of the required amount needed to absorb probable losses.

The allowance for loan losses was $14.5 million at December 31, 2006, compared to $14.7 million at December 31, 2005. Management considers the allowance adequate based upon its analysis of the portfolio as of December 31, 2006, however, no assurance can be made that additions to the allowance for loan losses will not be required in future periods.

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The following table details loan charge-offs and recoveries by loan type for the five years ended December 31, 2002 through 2006.

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(Amounts in thousands)				
Allowance for loan losses at beginning of period	$ 14,736	$ 16,339	$ 14,624	$ 14,410	$ 13,952
Acquisition balances			1,786	1,583	395
Charge-offs:					
Commercial, financial, agricultural and commercial real estate	1,953	5,017	1,925	3,302	2,162
Real estate-residential	1,234	385	723	686	464
Installment	1,356	1,534	1,526	2,133	2,243
Total charge-offs	4,543	6,936	4,174	6,121	4,869
Recoveries:					
Commercial, financial and agricultural	1,032	1,413	727	711	167
Real estate-residential	125	188	90	58	129
Installment	493	418	615	564	428
Total recoveries	1,650	2,019	1,432	1,333	724
Net charge-offs	2,893	4,917	2,742	4,788	4,145
Provision charged to operations	2,706	3,706	2,671	3,419	4,208
Reclassification of allowance for lending-related commitments(1)		(392)			
Allowance for loan losses at end of period	$ 14,549	$ 14,736	$ 16,339	$ 14,624	$ 14,410
Ratio of net charge-offs to average loans outstanding	0.22%	0.38%	0.24%	0.49%	0.45%
Ratio of allowance for loan losses to total loans outstanding	1.13%	1.11%	1.32%	1.43%	1.55%

(1) At June 30, 2005, the Company reclassified $392 thousand of its allowance for loan losses to a separate allowance for lending-related liabilities. Net income and prior period balances were not affected by this reclassification. The allowance for lending-related liabilities is included in other liabilities.

The following table details the allocation of the allowance for loan losses and the percent of loans in each category to total loans for the five years ended December 31, 2006.

December 31,				
2006	2005	2004	2003	2002

(Dollars in thousands)

Commercial, financial and agricultural	$	8,418	53%	$	9,993	58%	$	11,700	57%	$	9,414	47%	$	8,905	47%
Real estate mortgage		3,858	39%		2,462	34%		2,084	34%		2,207	41%		1,684	39%
Consumer		2,273	8%		2,281	8%		2,555	9%		3,003	12%		3,821	14%
Unallocated			0%			0%			0%			0%			0%
Total	$	14,549	100%	$	14,736	100%	$	16,339	100%	$	14,624	100%	$	14,410	100%

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Risk Elements

Non-performing assets include loans on non-accrual status, loans contractually past due 90 days or more and still accruing interest, and other real estate owned. The levels of non-performing assets for the last five years are presented in the following table.

	December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Dollars in thousands)				
Non-accrual loans	$ 3,813	$ 3,383	$ 5,168	$ 2,993	$ 3,075
Loans 90 days or more past due and still accruing interest		11			91
Total non-performing loans	3,813	3,394	5,168	2,993	3,166
Other real estate owned	258	1,400	1,419	2,091	2,855
Total non-performing assets	$ 4,071	$ 4,794	$ 6,587	$ 5,084	$ 6,021
Non-performing loans as a percentage of total loans	0.30%	0.25%	0.42%	0.29%	0.34%
Non-performing assets as a percentage of total loans and other real estate owned	0.32%	0.36%	0.53%	0.49%	0.65%
Allowance for loan losses as a percentage of non-performing loans	381.6%	434.2%	316.2%	488.6%	455.1%
Allowance for loan losses as a percentage of non-performing assets	357.4%	307.4%	248.0%	287.6%	239.3%

Total non-performing assets were $4.1 million at December 31, 2006, compared to $4.8 million at December 31, 2005, a decrease of $723 thousand. Non-accrual loans increased by $430 thousand to $3.8 million at December 31, 2006. Ongoing activity within the classification and categories of non-performing loans continues to include collections on delinquent loans, foreclosures, and movements into or out of the non-performing classification as a result of changing customer business conditions. There were no loans 90 days past due and still accruing at December 31, 2006, and $11 thousand at December 31, 2005. Other real estate owned decreased $1.1 million to $258 thousand in 2006 and is carried at the lesser of estimated net realizable value or cost.

Certain loans included in the non-accrual category have been written down to the estimated realizable value or have been assigned specific reserves within the allowance for loan losses based upon management s estimate of loss upon ultimate resolution.

During 2006, 2005 and 2004, $1.3 million, $1.3 million, and $2.1 million, respectively, of assets were acquired through foreclosure and transferred to other real estate owned.

The Company has considered all impaired loans in the evaluation of the adequacy of the allowance for loan losses at December 31, 2006. The following table presents additional detail of non-performing and restructured

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loans for the five years ended December 31, 2006. Additional information regarding nonperforming loans can be found in Note 5 of the Notes to Consolidated Financial Statements, included in Item 8 hereof.

Non-Performing Loans

	December 31,				
	2006	2005	2004	2003	2002
	(Amounts in thousands)				
Non-accruing loans	$ 3,813	$ 3,383	$ 5,168	$ 2,993	$ 3,075
Loans past due over 90 days and still accruing interest		11			91
Restructured loans performing in accordance with modified terms	272	302	354	356	345
Gross interest income which would have been recorded under original terms of non-accruing and restructured loans	397	380	439	282	222
Actual interest income during the period	286	161	293	194	108

There are no outstanding commitments to lend additional funds to borrowers related to restructured loans.

At December 31, 2006, there were no significant potential problem loans requiring disclosure beyond those addressed in the preceding tables.

Deposits

Total deposits decreased by $8.5 million, or 0.6%, during 2006. Noninterest-bearing demand deposits increased during 2006 by $14.2 million, or 6.2%, while interest-bearing demand deposits decreased $3.7 million, or 2.6%. Savings deposits, which consist of money market accounts and passbook savings, decreased $37.5 million during 2006, or 10.6%, while time deposits increased $18.6 million, or 2.8%.

Average total deposits remained steady at $1.41 billion for 2006. Average non-interest bearing demand deposits and time deposits increased $8.9 million and $21.9 million during 2006, respectively. Average interest-bearing demand deposits and savings deposits decreased $6.5 and $24.5 million during 2006, respectively. In 2006, the average rate paid on interest bearing deposits was 2.89%, up significantly from 2.03% in 2005. The attrition from interest-bearing demand and savings deposits and the continued increase in time deposits reflects the migration of new and current customer funds in response to the upward movement in time deposit interest rates.

Average Deposits and Average Rates

	2006			2005			2004		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Ra
	(Dollars in thousands)								
st-bearing liabilities:									
nd deposits	$ 146,248	$ 462	0.32%	$ 152,774	$ 401	0.26%	$ 149,502	$ 366	0
gs deposits	343,854	6,857	1.99%	368,339	4,309	1.17%	366,074	3,112	0

deposits	683,418	26,549	3.88%	661,498	19,321	2.92%	615,346	15,001	2
interest-bearing its	$ 1,173,520	$ 33,868	2.89%	$ 1,182,611	$ 24,031	2.03%	$ 1,130,922	$ 18,479	1
nterest bearing nd deposits	$ 237,714			$ 228,781			$ 212,777		

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Borrowings

The Company s borrowings consist primarily of overnight federal funds purchased from the FHLB and other sources, securities sold under agreements to repurchase, and term FHLB borrowings. This category of liabilities represents wholesale sources of funding and liquidity for the Company.

Short-term borrowings increased on average approximately $22.3 million compared to the prior year as a result of continued increases in portfolio assets. Funding cost is managed by the Company s Asset/Liability Management Committee, which monitors, among other things, product and pricing, overall cost of funds, and maintenance of an acceptable net interest margin.

Federal funds purchased were $7.7 million and $82.5 million, at December 31, 2006 and 2005, respectively. Repurchase agreements were $201.2 million and $124.2 million at December 31, 2006 and 2005, respectively. Retail repurchase agreements are sold to customers as an alternative to available deposit products. At December 31, 2006, total repurchase agreements included $50 million of wholesale instruments. The Company added $50 million of wholesale repurchase agreement funding during 2006. The weighted-average rate of those repurchase agreements was 4.30% at December 31, 2006. There were no wholesale repurchase agreements at the end of 2005. The underlying securities included in repurchase agreements remain under the Company s control during the effective period of the agreements.

Short-term borrowings include overnight federal funds, and repurchase agreements. Balances and rates paid on short-term borrowings for continuing operations are summarized as follows:

	2006		2005		2004	
	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)					
At year-end	$ 208,885	3.70%	$ 206,654	2.79%	$ 142,357	1.55%
Average during the year	150,839	3.37%	128,551	2.16%	109,223	1.29%
Maximum month-end balance	208,885		206,654		142,357	

In January 2006, the Company borrowed $75 million in new adjustable-rate advances from the FHLB. $50 million of the advances were hedged by an interest rate swap to approximate a fixed rate of 4.34%. The remaining $25 million floats at an interest rate equal to 3-month LIBOR less 45 basis points.

At December 31, 2006, FHLB borrowings included $175.0 million in convertible and callable advances and $7.2 million of noncallable advances for a total of $182.2 million. The weighted-average interest rates of all advances were 4.64% and 4.17% at December 31, 2006 and 2005, respectively. After considering the effect of the interest rate swap, the weighted-average interest rate of all advances was 4.26% at December 31, 2006. At December 31, 2006, the FHLB advances had maturities between one month and 14 years.

The scheduled maturities of the FHLB advances are as follows:

	(Amounts in thousands)
2007	$ 6,250
2008	

2009	
2010	25,000
2011	