

OLD POINT FINANCIAL CORP
Form 10-Q
August 09, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from _____ to _____

Commission File Number: 000-12896

OLD POINT FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

VIRGINIA
(State or other jurisdiction of

incorporation or organization)

1 West Mellen Street, Hampton, Virginia 23663

(Address of principal executive offices) (Zip Code)

54-1265373
(I.R.S. Employer

Identification No.)

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(757) 728-1200

(Registrant's telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

3,944,711 shares of common stock (\$5.00 par value) outstanding as of July 31, 2007

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OLD POINT FINANCIAL CORPORATION

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Consolidated Balance Sheets

	June 30, 2007 (unaudited)	December 31, 2006
Assets		
Cash and due from banks	\$ 14,562,221	\$ 18,571,359
Federal funds sold	7,873,332	18,213,002
Cash and cash equivalents	22,435,553	36,784,361
Securities available-for-sale, at fair value	157,080,132	184,806,097
Securities held-to-maturity (fair value approximates \$3,643,626 and \$3,454,019)	3,632,000	3,432,000
Loans, net of allowance for loan losses of \$5,088,475 and \$4,783,685	585,026,086	578,809,269
Premises and equipment, net	25,962,703	26,409,594
Bank owned life insurance	10,905,060	10,608,106
Other assets	7,149,605	6,671,859
	\$ 812,191,139	\$ 847,521,286
Liabilities & Stockholders Equity		
Deposits:		
Noninterest-bearing deposits	\$ 97,545,219	\$ 96,652,975
Savings and interest-bearing demand deposits	203,638,316	201,273,300
Time deposits	297,164,739	290,488,326
Total deposits	598,348,274	588,414,601
Federal funds purchased, repurchase agreements and other borrowings	43,954,837	57,052,656
Federal Home Loan Bank advances	90,000,000	125,000,000
Accrued expenses and other liabilities	2,810,298	2,388,777
Total liabilities	735,113,409	772,856,034
Stockholders Equity:		
Common stock, \$5 par value, 10,000,000 shares authorized; 3,979,111 and 3,992,155 shares issued	19,895,555	19,960,775
Additional paid-in capital	15,272,933	14,718,903
Retained earnings	43,597,768	42,245,413
Accumulated other comprehensive income (loss)	(1,688,526)	(2,259,839)
Total stockholders equity	77,077,730	74,665,252
	\$ 812,191,139	\$ 847,521,286

See Notes to Consolidated Financial Statements.

Table of Contents**Old Point Financial Corporation and Subsidiaries**

Consolidated Statements of Income

	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
	(unaudited)			
Interest and Dividend Income:				
Interest and fees on loans	\$ 10,469,595	\$ 9,005,132	\$ 20,706,778	\$ 17,304,167
Interest on federal funds sold	143,794	80,839	297,276	133,164
Interest on securities:				
Taxable	1,150,858	1,277,567	2,374,728	2,565,640
Tax-exempt	321,179	366,956	647,651	755,240
Dividends and interest on all other securities	95,625	91,649	221,361	178,998
Total interest and dividend income	12,181,051	10,822,143	24,247,794	20,937,209
Interest Expense:				
Interest on savings and interest-bearing demand deposits	660,470	571,012	1,293,233	1,064,605
Interest on time deposits	3,343,068	2,526,873	6,654,799	4,805,638
Interest on federal funds purchased, securities sold under agreement to repurchase and other borrowings	479,236	464,393	977,745	872,214
Interest on Federal Home Loan Bank advances	1,220,270	1,153,712	2,635,293	2,138,046
Total interest expense	5,703,044	4,715,990	11,561,070	8,880,503
Net interest income	6,478,007	6,106,153	12,686,724	12,056,706
Provision for loan losses	200,000	300,000	500,000	600,000
Net interest income, after provision for loan losses	6,278,007	5,806,153	12,186,724	11,456,706
Noninterest Income:				
Income from fiduciary activities	782,777	661,486	1,579,691	1,338,900
Service charges on deposit accounts	1,449,876	1,391,562	2,842,823	2,725,497
Other service charges, commissions and fees	581,856	718,288	1,167,147	1,253,637
Income from bank owned life insurance	148,173	133,575	296,346	266,728
Gain on available-for-sale securities, net	0	550	3,168	1,896
Other operating income	170,528	119,456	322,581	225,612
Total noninterest income	3,133,210	3,024,917	6,211,756	5,812,270
Noninterest Expense:				
Salaries and employee benefits	4,040,113	3,825,051	7,942,411	7,536,647
Occupancy and equipment	889,194	885,790	1,787,781	1,777,310
Postage and courier	127,000	128,953	254,783	268,426
Service fees	91,010	200,459	166,041	369,186
Data processing	219,562	186,249	423,512	355,272
Advertising	203,081	189,364	376,382	331,207
Customer development	162,524	126,924	339,064	294,329
Employee professional development	176,384	160,248	325,604	291,284
Other	664,986	642,404	1,283,519	1,261,753
Total noninterest expenses	6,573,854	6,345,442	12,899,097	12,485,414

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Income before income taxes	2,837,363	2,485,628	5,499,383	4,783,562
Income tax expense	810,050	679,807	1,555,158	1,287,372
Net income	\$ 2,027,313	\$ 1,805,821	\$ 3,944,225	\$ 3,496,190

Basic Earnings per Share:

Average shares outstanding	3,991,871	3,988,674	3,990,649	3,991,815
Net income per share of common stock	\$ 0.51	\$ 0.45	\$ 0.99	\$ 0.88

Diluted Earnings per Share:

Average shares outstanding	4,025,297	4,049,006	4,028,333	4,052,729
Net income per share of common stock	\$ 0.50	\$ 0.45	\$ 0.98	\$ 0.86

See Notes to Consolidated Financial Statements.

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Consolidated Statements of Changes in Stockholders' Equity

(Unaudited)	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
FOR SIX MONTHS ENDED JUNE 30, 2007						
Balance at beginning of period	3,992,155	\$ 19,960,775	\$ 14,718,903	\$ 42,245,413	\$ (2,259,839)	\$ 74,665,252
Comprehensive income:						
Net income				3,944,225		3,944,225
Unrealized holding gains arising during the period (net of tax, \$295,390)					573,404	573,404
Reclassification adjustment (net of tax, \$1,077)					(2,091)	(2,091)
Total comprehensive income				3,944,225	571,313	4,515,538
Sale of common stock	17,741	88,705	548,909	(482,693)		154,921
Repurchase and retirement of common stock	(30,785)	(153,925)		(672,727)		(826,652)
Nonqualified stock options			5,121			5,121
Cash dividends (\$.36 per share)				(1,436,450)		(1,436,450)
 Balance at end of period	 3,979,111	 \$ 19,895,555	 \$ 15,272,933	 \$ 43,597,768	 \$ (1,688,526)	 \$ 77,077,730
FOR SIX MONTHS ENDED JUNE 30, 2006						
Balance at beginning of period	4,013,553	\$ 20,067,765	\$ 14,319,580	\$ 39,074,325	\$ (2,405,624)	\$ 71,056,046
Comprehensive income:						
Net income				3,496,190		3,496,190
Unrealized holding losses arising during the period (net of tax, \$436,492)					(847,309)	(847,309)
Reclassification adjustment (net of tax, \$645)					(1,251)	(1,251)
Total comprehensive income				3,496,190	(848,560)	2,647,630
Sale of common stock	10,070	50,350	280,835	(180,768)		150,417
Repurchase and retirement of common stock	(32,318)	(161,590)		(769,203)		(930,793)
Nonqualified stock options			19,457			19,457
Cash dividends (\$.34 per share)				(1,355,569)		(1,355,569)
 Balance at end of period	 3,991,305	 \$ 19,956,525	 \$ 14,619,872	 \$ 40,264,975	 \$ (3,254,184)	 \$ 71,587,188

See Notes to Consolidated Financial Statements.

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Consolidated Statements of Cash Flows

	Six Months Ended	
	2007	June 30, 2006 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3,944,225	\$ 3,496,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	844,302	777,825
Provision for loan losses	500,000	600,000
Net gain on sale of available-for-sale securities	(3,168)	(1,896)
Net accretion of securities	(32,065)	(24,079)
Gain on disposal of equipment	(16,490)	(180)
Increase in bank-owned life insurance	(296,954)	(866,728)
Increase in other assets	(772,059)	(104,754)
Increase in other liabilities	421,521	866,450
Net cash provided by operating activities	4,589,312	4,742,828
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(3,372,130)	(4,028,813)
Purchases of held-to-maturity securities	(600,000)	(300,000)
Proceeds from maturities and calls of securities	30,628,954	8,472,000
Proceeds from sales of available-for-sale securities	1,770,000	1,275,000
Loans made to customers	(114,325,159)	(168,455,656)
Principal payments received on loans	107,608,342	113,199,064
Purchases of premises and equipment	(380,921)	(978,280)
Net cash provided by (used in) investing activities	21,329,086	(50,816,685)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in non-interest bearing deposits	892,244	(734,344)
Increase in savings deposits	2,365,016	4,311,926
Proceeds from the sale of time deposits	109,041,988	86,971,384
Payments for maturing time deposits	(102,365,575)	(70,483,834)
Increase (decrease) in federal funds purchased and repurchase agreements	(13,013,040)	1,018,878
Increase (decrease) in Federal Home Loan Bank advances	(35,000,000)	35,000,000
Decrease in interest-bearing demand notes and other borrowed money	(84,779)	(454,231)
Proceeds from issuance of common stock	154,921	150,417
Repurchase and retirement of common stock	(826,652)	(930,793)
Effect of nonqualified stock options	5,121	19,457
Cash dividends paid on common stock	(1,436,450)	(1,355,569)
Net cash provided by (used in) financing activities	(40,267,206)	53,513,291
Net increase (decrease) in cash and cash equivalents	(14,348,808)	7,439,434
Cash and cash equivalents at beginning of period	36,784,361	15,606,024
Cash and cash equivalents at end of period	\$ 22,435,553	\$ 23,045,458

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash payments for:

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Interest	\$ 11,779,907	\$ 8,571,212
Income tax	\$ 1,675,000	\$ 1,175,000

SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS

Unrealized gain (loss) on investment securities	\$ 865,626	\$ (1,285,697)
Loans transferred to other real estate owned	\$ 240,000	\$

See Notes to Consolidated Financial Statements.

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The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (the Company) and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications consisting of a normal and recurring nature considered necessary to present fairly the financial positions at June 30, 2007 and December 31, 2006, the results of operations for the three months and six months ended June 30, 2007 and 2006, and statements of cash flows and changes in stockholders' equity for the six months ended June 30, 2007 and 2006. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2006. Certain previously reported amounts have been reclassified to conform to current period presentation.

The Company maintains a website on the Internet at www.oldpoint.com. The Company makes available free of charge, on or through its website, its proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). The information available at the Company's Internet address is not part of this Form 10-Q or any other report filed by the Company with the SEC. The public may read and copy any documents the Company files at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company's SEC filings can also be obtained on the SEC's website on the Internet at www.sec.gov.

Note 2. Securities

Amortized costs and fair values of securities held-to-maturity at June 30, 2007 and December 31, 2006 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
June 30, 2007				
Obligations of U.S. Government agencies	\$ 2,900	\$	\$ (18)	\$ 2,882
Obligations of state and political subdivisions	732	30		762
Total	\$ 3,632	\$ 30	\$ (18)	\$ 3,644
December 31, 2006				
Obligations of U.S. Government agencies	\$ 2,700	\$	\$ (24)	\$ 2,676
Obligations of state and political subdivisions	732	46		778
Total	\$ 3,432	\$ 46	\$ (24)	\$ 3,454

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Amortized costs and fair values of securities available-for-sale at June 30, 2007 and December 31, 2006 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
June 30, 2007				
United States Treasury securities	\$ 982	\$	\$ (1)	\$ 981
Obligations of U.S. Government agencies	123,255		(1,811)	121,444
Obligations of state and political subdivisions	27,689	237		27,926
Money market investments	851			851
Federal Home Loan Bank stock - restricted	5,565			5,565
Federal Reserve Bank stock - restricted	169			169
Other marketable equity securities	168		(24)	144
Total	\$ 158,679	\$ 237	\$ (1,836)	\$ 157,080
December 31, 2006				
United States Treasury securities	\$ 981	\$	\$	\$ 981
Obligations of U.S. Government agencies	148,981		(2,895)	146,086
Obligations of state and political subdivisions	29,157	458		29,615
Money market investments	721			721
Federal Home Loan Bank stock - restricted	7,094			7,094
Federal Reserve Bank stock - restricted	169			169
Other marketable equity securities	168		(28)	140
Total	\$ 187,271	\$ 458	\$ (2,923)	\$ 184,806

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Information pertaining to securities with gross unrealized losses at June 30, 2007 and December 31, 2006, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than Twelve Months		June 30, 2007 More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale						
Debt securities:						
United States Treasury securities	\$ 1	\$ 981	\$	\$	\$ 1	\$ 981
Obligations of U.S. Government agencies			1,811	121,444	1,811	121,444
Total debt securities	1	981	1,811	121,444	1,812	122,425
Other marketable equity securities			24	26	24	26
Total securities available-for-sale	\$ 1	\$ 981	\$ 1,835	\$ 121,470	\$ 1,836	\$ 122,451
Securities Held-to-Maturity						
Obligations of U.S. Government agencies	\$ 4	\$ 1,596	\$ 14	\$ 1,286	\$ 18	\$ 2,882
Total securities held-to-maturity	\$ 4	\$ 1,596	\$ 14	\$ 1,286	\$ 18	\$ 2,882
Total	\$ 5	\$ 2,577	\$ 1,849	\$ 122,756	\$ 1,854	\$ 125,333

	Less Than Twelve Months		December 31, 2006 More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale						
Debt securities:						
Obligations of U.S. Government agencies	\$	\$	\$ 2,895	\$ 146,087	\$ 2,895	\$ 146,087
Total debt securities			2,895	146,087	2,895	146,087
Other marketable equity securities			28	22	28	22
Total securities available-for-sale	\$	\$	\$ 2,923	\$ 146,109	\$ 2,923	\$ 146,109
Securities Held-to-Maturity						
Obligations of U.S. Government agencies	\$ 1	\$ 499	\$ 23	\$ 1,677	\$ 24	\$ 2,176
Total securities held-to-maturity	\$ 1	\$ 499	\$ 23	\$ 1,677	\$ 24	\$ 2,176
Total	\$ 1	\$ 499	\$ 2,946	\$ 147,786	\$ 2,947	\$ 148,285

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The Company has the ability and intent to hold these securities until maturity. The securities are impaired primarily due to rising interest rates. None of the securities is impaired due to credit issues. Therefore, securities with a loss are considered temporarily impaired.

Note 3. Loans

Loans at June 30, 2007 and December 31, 2006 are summarized as follows:

	June 30, 2007	December 31, 2006
	(in thousands)	
Commercial and other loans	\$ 74,875	\$ 67,697
Real estate loans:		
Construction	71,732	81,227
Farmland	50	220
Equity lines of credit	27,942	26,809
1-4 family residential	122,942	120,915
Multifamily residential	7,220	5,898
Nonfarm nonresidential	224,783	213,606
Installment loans to individuals	57,057	63,670
Tax-exempt loans	3,137	3,191
Total loans	589,738	583,233
Less: Allowance for loan losses	(5,088)	(4,784)
Net deferred loan costs	376	360
Loans, net	\$ 585,026	\$ 578,809

Note 4. Allowance for Loan Losses

The following summarizes activity in the allowance for loan losses at June 30, 2007 and December 31, 2006:

	June 30, 2007	December 31, 2006
	(in thousands)	
Balance, beginning of year	\$ 4,784	\$ 4,448
Recoveries	154	331
Provision for loan losses	500	1,200
Loans charged off	(350)	(1,195)
Balance, end of period	\$ 5,088	\$ 4,784

Note 5. Share-Based Compensation

Share-based compensation arrangements include stock options, restricted stock awards, performance-based awards, stock appreciation rights and employee stock purchase plans. Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (SFAS No. 123R) requires all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period. SFAS No. 123R was adopted by the Company as of January 1, 2006. The Company has not issued any new options since SFAS No. 123R became effective.

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The Company has stock option plans which have 380,869 shares of common stock reserved for grants to key employees and directors. Currently, 200,051 shares of common stock from these plans are outstanding at June 30, 2007. The exercise price of each option equals the market price of the Company's common stock on the date of the grant and an option's maximum term is ten years.

Stock option plan activity for the six months ended June 30, 2007 is summarized below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding, January 1	243,747	\$ 22.28		
Granted				
Exercised	(24,696)	13.99		
Canceled or expired	(19,000)	25.06		
Options outstanding, June 30	200,051	23.04	4.16	\$ 899,156
Options exercisable, June 30	200,051	\$ 23.04	4.16	\$ 899,156

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on June 30, 2007. This amount changes based on changes in the market value of the Company's stock.

The total proceeds of options exercised during the first six months ended June 30, 2007 was \$345 thousand. The intrinsic value for options exercised during the first six months ended June 30, 2007 was \$327 thousand.

As of June 30, 2007, there was no unrecognized compensation expense because all outstanding options were vested.

SFAS No. 123R requires the benefits of tax deductions in excess of grant-date fair value to be reported as a financing cash flow. The Company did have a \$5 thousand tax benefit deduction from the exercise of stock options in the first six months of 2007.

Note 6. Pension Plan

The Company provides pension benefits for eligible participants through a non-contributory defined benefits pension plan. The plan was frozen effective September 30, 2006; therefore no additional participants will be added to the plan. The components of net periodic pension cost are as follows:

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Quarter ended June 30,	2007	2006
Service cost	\$	\$ 126,049
Interest cost	71,948	83,788
Expected return on plan assets	(102,902)	(96,067)
Amortization of prior service cost		320
Amortization of net loss	8,606	44,789
 Net periodic pension plan cost (benefit)	 \$ (22,348)	 \$ 158,879
 Six months ended June 30,	 2007	 2006
Service cost	\$	\$ 252,098
Interest cost	143,895	167,576
Expected return on plan assets	(205,803)	(192,134)
Amortization of prior service cost		640
Amortization of net loss	17,211	89,578
 Net periodic pension plan cost (benefit)	 \$ (44,697)	 \$ 317,758

The Company has not made, and does not expect to make, any contributions to the plan in 2007.

Note 7. Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares attributable to outstanding stock options.

Potential common shares outstanding attributable to stock options in the amount of 117 thousand were not included in the diluted earnings per share calculation because they were antidilutive.

Note 8. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The Company does not expect the implementation of SFAS 157 to have a material impact on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of this Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument and is irrevocable. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is in the process of evaluating the impact SFAS 159 may have on its consolidated financial statements.

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

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company. The Company consists of the parent company and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services, N. A. (Trust), collectively referred to as the Company. This discussion should be read in conjunction with the consolidated financial statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements

In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy and financial and other goals. Forward-looking statements often use words such as believes, expects, plans, may, will, should, projects, contemplates, and forecasts, intends or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

Factors that could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to, changes in: interest rates, general economic conditions, monetary and fiscal policies of the U.S. Government, including policies of the Office of the Comptroller of the Currency, U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

General

The Company is the parent company of the Bank and Trust. The Bank is a locally owned and managed community bank serving the Hampton Roads localities of Hampton, Newport News, Norfolk, Virginia Beach, Chesapeake, Williamsburg/James City County, York County and Isle of Wight County. The Bank currently has 19 branch offices. Trust is a wealth management services provider.

Critical Accounting Policies and Estimates

As of June 30, 2007, there have been no significant changes with regard to the critical accounting policies and estimates disclosed in the Company's annual report on Form 10-K for the year ended December 31, 2006. That disclosure included a discussion of the accounting policy that requires management's most difficult, subjective or complex judgments: the allowance for loan losses.

Earnings Summary

Net income for the second quarter of 2007 was \$2.0 million as compared with \$1.8 million earned in the comparable quarter in 2006, an increase of 12.27%. Basic and diluted earnings per share for the second quarter 2007 were \$0.51 and \$0.50. Basic and diluted earnings per share for the second quarter of 2006 were \$0.45. Annualized return on average assets (ROA) for the second quarter of 2007 was 0.99% and 0.93% for the comparable period in 2006. Return on equity (ROE) was 10.52% for the second quarter of 2007 compared with 10.09% for the same period in 2006.

Net Interest Income

The principal source of earnings for the Company is net interest income. Net interest income is the difference between interest and fees generated by earning assets and interest expense paid to fund them. Changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as their respective yields and rates, have a significant impact on the level of net interest income. The net interest margin is calculated by dividing tax equivalent net interest income by average earning assets.

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Net interest income, on a fully tax equivalent basis, was \$6.7 million in the second quarter of 2007, an increase of \$348 thousand from the second quarter of 2006. The net interest margin was 3.45% in the second quarter of both 2007 and 2006. The net interest margin improved 18 basis points from 3.27% in the first quarter of 2007. This improvement is largely due to improving loan yield.

Tax equivalent interest income increased \$1.3 million, or 12.10%, in the second quarter of 2007 compared to the same period of 2006. Average earning assets grew \$40.2 million, or 5.50%. The average yield on earning assets increased in 2007 by 38 basis points.

For the six months ended June 30, 2007 net interest income on a fully tax equivalent basis increased \$575 thousand, or 4.61%, over the comparable period in 2006. Comparing the first six months of 2007 to 2006, average loans increased \$67.8 million, or 13.09%, while investment securities decreased \$16.2 million, or 8.26%. Average earning assets increased 7.96% and the net interest yield decreased from 3.47% in 2006 to 3.36% in 2007, a reduction of 11 basis points.

Interest expense increased \$987 thousand, or 20.93%, and average interest-bearing liabilities increased 6.67% in the second quarter of 2007 compared to the same period of 2006. The cost of funding those liabilities increased 41 basis points. For the six months ended June 30, 2007 interest expense increased \$2.7 million, or 30.19%, over the same period in 2006.

The following table shows an analysis of average earning assets, interest-bearing liabilities and rates and yields. Nonaccrual loans are included in loans outstanding.

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AVERAGE BALANCE SHEETS, NET INTEREST INCOME* AND RATES*

	For the quarter ended June 30,					
	Average Balance	2007 Interest Income/ Expense	Yield/ Rate**	Average Balance (in thousands)	2006 Interest Income/ Expense	Yield/ Rate**
Loans	\$ 587,625	\$ 10,489	7.14%	\$ 530,477	\$ 9,025	6.81%
Investment securities:						
Taxable	145,674	1,247	3.42%	162,946	1,370	3.36%
Tax-exempt	27,654	487	7.04%	31,592	556	7.04%
Total investment securities	173,328	1,734	4.00%	194,538	1,926	3.96%
Federal funds sold	11,021	144	5.23%	6,713	81	4.83%
Total earning assets	771,974	\$ 12,367	6.41%	731,728	\$ 11,032	6.03%
Allowance for loan losses	(5,085)			(4,502)		
Other nonearning assets	55,719			49,684		
Total assets	\$ 822,608			\$ 776,910		
Time and savings deposits:						
Interest-bearing transaction accounts	\$ 11,596	\$ 7	0.24%	\$ 9,229	\$ 6	0.26%
Money market deposit accounts	157,056	602	1.53%	153,455	513	1.34%
Savings accounts	39,970	51	0.51%	41,425	52	0.50%
Time deposits, \$100,000 or more	104,424	1,280	4.90%	85,795	899	4.19%
Other time deposits	183,639	2,063	4.49%	167,024	1,628	3.90%
Total time and savings deposits	496,685	4,003	3.22%	456,928	3,098	2.71%
Federal funds purchased, repurchase agreements and other borrowings	49,145	480	3.91%	50,904	464	3.65%
Federal Home Loan Bank advances	99,723	1,220	4.89%	97,333	1,154	4.74%
Total interest-bearing liabilities	645,553	5,703	3.53%	605,165	4,716	3.12%
Demand deposits	97,303			98,259		
Other liabilities	2,641			1,936		
Stockholders' equity	77,111			71,550		
Total liabilities and stockholders' equity	\$ 822,608			\$ 776,910		
Net interest income/yield		\$ 6,664	3.45%		\$ 6,316	3.45%