FIRST NATIONAL CORP /VA/
Form 10QSB
August 14, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended JUNE 30, 2003

[ ] 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 0-23976

FIRST NATIONAL CORPORATION
(Exact Name of Registrant as Specified in its Charter)

VIRGINIA	54-1232965
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

112 WEST KING STREET, STRASBURG, VIRGINIA 22657
(Address of Principal Executive Offices)

540-465-9121
(Registrant's Telephone Number, Including Area Code)

N/A
(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

Indicate by check 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 _X_. No ___.

As of AUGUST 11, 2003, the number of outstanding shares of registrant's common stock, par value $2.50 per share was: 1,462,062.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

FIRST NATIONAL CORPORATION
Consolidated Balance Sheets
(In thousands of dollars except per share data)

	(Unaudited) June 30, 2003
ASSETS:	
Cash and due from banks	$ 14,844
Federal funds sold	11,789
Securities available-for-sale, at fair value	53,245
Loans held for sale	-
Loans, net of allowance for loan losses of $2,369 and $2,162	225,380
Bank premises and equipment, net	10,180
Accrued interest receivable	1,351
Other assets	2,954
Total assets	$ 319,743
LIABILITIES:	
Deposits	
Non-interest bearing demand deposits	$ 51,971
Savings and interest bearing demand deposits	109,313
Time deposits	104,160
Total deposits	265,444
Long-term debt	26,580
Trust preferred capital notes	3,000
Accrued expenses and other liabilities	2,052
Total liabilities	297,076
STOCKHOLDERS' EQUITY:	
Common stock; par value $2.50 and $5.00 per share; authorized 4,000,000 and 2,000,000 shares; issued and outstanding 1,462,062 shares June 30, 2003 and outstanding 790,031 shares December 31, 2002, respectively	$ 3,655
Surplus	1,465
Retained earnings	16,486
Accumulated other comprehensive income	1,061
Total stockholders' equity	22,667

Total liabilities and stockholders' equity	$ 319,743

Notes to consolidated financial statements are an integral part of these statements.

FIRST NATIONAL CORPORATION
Consolidated Statements of Income
(In thousands of dollars except per share data)
(Unaudited)

	Three Months Ended June 30, 2003	2002
INTEREST AND DIVIDEND INCOME:		
Interest and fees on loans	$ 3,903	$ 3,533
Interest on federal funds sold	10	26
Interest on deposits in banks	8	7
Interest and dividends on securities available for sale:		
Taxable	469	547
Nontaxable	89	77
Total interest and dividend income	4,479	4,190
INTEREST EXPENSE:		
Interest on deposits	1,341	1,502
Interest on federal funds purchased	1	-
Interest on long-term debt	411	410
Total interest expense	1,753	1,912
Total non-interest income	2,726	2,278
Provision for loan losses	172	90
Net interest income after provision for loan losses	2,554	2,188
NONINTEREST INCOME:		
Service charges and other fees	580	250
Gains on sale of securities	-	44
Gains on sale of loans	133	32
Other	199	187
Total non-interest income	912	513
NONINTEREST EXPENSES:		
Salaries and employee benefits	1,175	816
Occupancy expense	123	121
Equipment expense	183	146
Advertising	84	96
Professional fees	73	24
Other operating		

expense	636	506
Total non-interest expenses	2,274	1,709
Income before income taxes	1,192	992
Provision for income taxes	400	316
NET INCOME	$792	$ 676
EARNINGS PER COMMON SHARE, basic and diluted *	0.54	0.43
CASH DIVIDENDS PER COMMON SHARE*	0.19	0.17
Average common shares outstanding basic and diluted *	1,462,062	1,580,062

Notes to consolidated financial statements are an integral part of these statements.

*Restated to give retroactive effect of the two-for-one stock split declared on April 16, 2003 and payable as of May 30, 2003.

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FIRST NATIONAL CORPORATION
Consolidated Statements of Income
(In thousands of dollars except per share data)
(Unaudited)

	Six Months Ended June 30, 2003	2002
INTEREST AND DIVIDEND INCOME:		
Interest and fees on loans	$ 7,602	$ 7,032
Interest on federal funds sold	25	62
Interest on deposits in banks	18	14
Interest and dividends on securities available for sale:		
Taxable	973	1,007
Nontaxable	161	154
Total interest and dividend income	8,779	8,269
INTEREST EXPENSE:		
Interest on deposits	2,710	2,936
Interest on federal funds purchased	1	-
Interest on long-term debt	817	840
Total interest expense	3,528	3,776
Net interest income	5,251	4,493
Provision for loan losses	330	180

Net interest income after provision for loan losses	4,921	4,313
NONINTEREST INCOME:		
Service charges and other fees	1,107	491
Gains on sale of securities	16	114
Gains on sale of loans	213	69
Other	381	358
Total non-interest income	1,717	1,032
NONINTEREST EXPENSES:		
Salaries and employee benefits	2,205	1,609
Occupancy expense	251	235
Equipment expense	362	280
Advertising	157	160
Professional fees	145	65
Other operating expense	1,219	980
Total non-interest expenses	4,339	3,329
Income before income taxes	2,299	2,016
Provision for income taxes	763	638
NET INCOME	$1,536	$1,378
EARNINGS PER COMMON SHARE, basic and diluted *	$1.03	$0.87
CASH DIVIDENDS PER COMMON SHARE*	$0.37	$0.34
Average common shares outstanding basic and diluted *	1,497,918	1,580,062

Notes to consolidated financial statements are an integral part of these statements.

*Restated to give retroactive effect of the two-for-one stock split declared on April 16, 2003 and payable as of May 30, 2003.

FIRST NATIONAL CORPORATION
Consolidated Statements of Changes in Stockholders' Equity
For the six months ended June 30, 2003 and 2002
(In thousands of dollars)
(Unaudited)

	Common Stock	Surplus	Retained Earnings	Accumu Comprehe Income (
Balance, December 31, 2001	$3,950	$ 1,465	$ 15,770	

Comprehensive Income:			
Net income	--	--	1,378
Other comprehensive income, net of tax			
Unrealized holding gains on securities available-for-sale arising during the period (net of tax of $257)			
Reclassification on adjustment (net of tax of $39)			
Other comprehensive income (net of tax of $218)	--	--	--
Total comprehensive income			
Cash dividends paid $.34	--	--	(537)
Balance, June 30, 2002	$3,950	$ 1,465	$ 16,611

	Common Stock	Surplus	Retained Earnings	Accumu Other Comprehe Income
Balance, December 31, 2002	$ 3,950	$ 1,465	$ 17,659	$
Comprehensive income:				
Net income	--	--	1,536	
Other comprehensive loss net of tax, unrealized (loss) arising during the period (net of tax, $57)				
Reclassification adjustment (net of tax, $5)				
Other comprehensive loss (net of tax, $62)	--	--		
Total comprehensive income				
Acquisition of 118,000 shares of common stock	(295)		(2,154)	
Cash dividends paid $.38	--	--	(555)	
Balance, June 30, 2003	$3,655	$1,465	$16,486	$

Notes to consolidated financial statements are an integral part of these statements

FIRST NATIONAL CORPORATION
Consolidated Statements of Cash Flows
(In thousands of dollars)
(Unaudited)

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,536	$ 1,378
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	286	205
Origination of loans available for sale	(14,436)	(6,010)
Proceeds from loans available for sale	15,997	6,788
Provision for loan losses	330	180
(Gain) on sale of securities available-for-sale	(16)	(114)
Accretion of security discounts	(17)	(7)
(Gain) on sale of loans	(213)	(69)
Amortization of security premiums, net	282	139
Changes in other assets and other liabilities:		
(Increase) decrease in accrued interest receivable	52	(70)
(Increase) in other assets	(303)	(205)
Increase in accrued expenses and other liabilities	48	153
Net cash provided by operating activities	$ 3,546	$ 2,368
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net (increase) in loans	$(15,270)	$ (9,281)
Purchase of securities available-for-sale	(11,570)	(17,574)
Proceeds from sales of securities available-for-sale	1,081	5,352
Proceeds from calls, maturities, and principal payments on securities available-for-sale	10,773	4,636
(Increase) in federal funds sold	(8,998)	(215)
Purchase of bank premises and equipment	(2,041)	(1,191)
Net cash (used in) investing activities	$(26,025)	$(18,273)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand and savings deposits	$ 17,584	$ 17,748
Net increase in time deposits	4,848	5,906
Net (decrease) in long-term debt	(25)	(2,076)
Proceeds from issuance of trust preferred capital notes	3,000	--
Cash dividends paid	(555)	(537)
Acquisition of common stock	(2,449)	--
Net cash provided by financing activities	$ 22,403	$ 21,041
Net increase (decrease) in cash and cash equivalents	(76)	$ 5,136
CASH AND CASH EQUIVALENTS -- BEGINNING OF PERIOD	14,920	6,754
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 14,844	$ 11,890
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for interest	$ 3,574	$ 3,800
Cash payments for income taxes	$ 690	$ 578

INVESTING AND FINANCING		
Unrealized gain (loss) on securities available for sale	$ (181)	$ 642

Notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General

The accompanying unaudited consolidated financial statements of First National Corporation and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America 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 as of June 30, 2003 and December 31, 2002, the results of operations for the three and six months ended June 30, 2003 and 2002, and statements of cash flows and changes in stockholders' equity for the six months ended June 30, 2003 and 2002.

Operating results for the six month period ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

2. Investment Securities

Amortized cost and carrying amount (estimated market value) of securities available-for-sale are summarized as follows:

	June 30, 2003		
	Amortized Cost	Gross Unrealized Gains	Gross Unreali Losse
	(in thousands of dol		
Obligations of U.S. government corporations and agencies	$ 43,633	$ 1,158	
Obligations of state/political subdivisions	6,417	379	
Corporate securities	3	71	
Other securities	1,584	--	
	$ 51,637	$ 1,608	

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FIRST NATIONAL CORPORATION
Notes to Consolidated Financial Statements
(Unaudited)

Securities available-for-sale at December 31, 2002 consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(in thousands of dollars)		
Obligations of U.S. government Corporations and agencies	$ 44,419	$ 1,423	$ --
Obligations of states/political subdivisions	6,002	235	--
Corporate securities	4	71	--
Other securities	2,271	--	--
	$ 52,696	$ 1,789	$ --

3. Loans

Major classifications of loans are summarized as follows:

	June 30, 2003	Decem
	(in thousands of	
Commercial	$ 30,805	
Real estate -1-4 family residential	67,243	
Real estate -secured by farmland	2,124	
Real estate -non-farm, non-residential	76,446	
Real estate -construction	15,395	
Consumer	35,736	
Total loans	227,749	
Less allowance for loan losses	(2,369)	
Loans, net	$ 225,380	

FIRST NATIONAL CORPORATION
Notes to Consolidated Financial Statements
(Unaudited)

4. Capital Requirements

A comparison of the capital of the Company and its wholly-owned subsidiary, First Bank (the "Bank"), as of June 30, 2003 with the minimum regulatory guidelines is as follows:

	Actual	Minimum Guidelines
Total Risk-Based Capital:		
Company	11.42%	8.00%
Bank	11.32%	8.00%
Tier 1 Risk-Based Capital:		
Company	10.40%	4.00%
Bank	10.32%	4.00%
Leverage Ratio:		
Company	7.97%	4.00%
Bank	7.86%	4.00%

5. Trust Preferred Capital Notes

On March 11, 2003, First National (VA) Statutory Trust I (the "Trust"), a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable capital securities. On March 26, 2003, $3 million of trust preferred securities were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest. The interest rate at June 30, 2003 was 4.16%. The securities have a mandatory redemption date of March 26, 2033, and are subject to varying call provisions beginning March 26, 2008. The principal asset of the Trust is $3 million of the Company's junior subordinated debt securities with maturities and interest rates like the capital securities.

The Trust preferred securities may be included in Tier I capital for regulatory capital adequacy purposes as long as their amount does not exceed 25% of Tier I capital, including total trust preferred securities. The portion of the trust preferred securities not considered as Tier I capital, if any, may be included in Tier 2 capital. The total amount ($3 million) of trust preferred securities issued by the Trust can be included in the Company's Tier I capital.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Forward-Looking Statements

This management's discussion and analysis and other portions of this report, contain forward-looking statements within the meaning of the Securities and Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In some cases, forward-looking statements can be identified by use of words such as "may," "will," "anticipates," "believes," "expects," "plans," "estimates," "potential," "continue," "should," and similar words or phrases. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors, and other conditions which by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty. Because of these uncertainties and the assumptions on which this discussion and the forward-looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward-looking statements. The Company does undertake to update any forward-looking statements to reflect occurrences or events that may not have been anticipated as of the date of such statements.

General

The following presents management's discussion and analysis of the consolidated financial condition and results of operations of First National Corporation and its subsidiaries (the "Company") as of the dates and for the periods indicated. This discussion should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto, and other financial data appearing elsewhere in this report. The Company is the parent bank holding company for First Bank (the "Bank"), a Virginia state chartered bank that offers a full range of banking services through nine branch offices, principally to individuals and small to medium-size businesses in the Northern Shenandoah Valley area, including the counties of Shenandoah, Frederick and Warren.

Critical Accounting Policies

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

ALLOWANCE FOR LOAN LOSSES. The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) Statement of Financial Accounting Standards (SFAS) No. 5 "Accounting for Contingencies," which requires that losses be accrued when they are probable of occurring and estimable and (ii) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

Our allowance for loan losses has two basic components: the specific allowance and the formula allowance. Both of these components is determined based upon estimates that can and do change when the actual events occur.

The specific allowance is used to individually allocate an allowance for larger balance, non-homogeneous loans. The specific allowance uses various techniques to arrive at an estimate of loss. First, analysis of

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the borrower's overall financial condition, resources and payment record; the prospects for support from financial guarantors; and the fair market value of collateral are used to estimate the probability and severity of inherent losses. Additionally, historical default rates and loss severities, internal risk ratings, industry and market conditions and trends, and other environmental factors are considered. The use of these values is inherently subjective and our actual losses could be greater or less than the estimates.

The formula allowance is used for estimating the loss on pools of smaller-balance, homogeneous loans; including residential mortgage loans, installment loans, other consumer loans, as well as outstanding loan commitments. Also, a formula allowance is used for the remaining pool of larger balance, non-homogeneous loans which were not allocated a specific allowance upon their review. The formula allowance begins with estimates of probable losses inherent in the homogeneous portfolio based upon various statistical analyses. These include analysis of historical delinquency and loss experience, together with analyses that reflect current economic trends and conditions. The formula allowance uses a historical loss view as an indicator of future losses. As a result, even though this history is regularly updated with the most recent loss information, it could differ from the loss incurred in the future.

Results of Operations

Total assets increased $23.8 million, or 8.0%, from $295.9 million at December 31, 2002 to $319.7 million at June 30, 2003 as total deposits grew $22.4 million, or 9.2%, from $243.0 million to $265.4 million. The deposit growth funded an increase in loans of $14.9 million and an increase of $9.0 million in federal funds sold.

Deposit growth occurred primarily from demand deposits, which increased $15.4 million or 42.1%, from $36.6 million at December 31, 2002 to $52.0 million at June 30, 2003. Other deposit categories also increased, with savings and interest bearing demand deposits increasing $2.2 million, or 2.1%, from $107.1 million to $109.3 million. Time deposits rose $4.8 million or 4.9% over the prior period.

For the six months ended June 30, 2003 net income of $1.5 million reflected an increase of 11.5% compared to $1.4 million for the six months ended June 30, 2002 as net interest income increased $758 thousand, or 16.9%, non-interest income rose $685 thousand, or 66.4%, and non-interest expense was up $1.0 million, or 30.3%. Provisions for loan losses for the six-month period increased over the prior year by $150 thousand. Earnings per share of $1.03 were up $0.16, or 18.4% from $.87 for the comparable period in 2002. The Company's annualized return on average assets and return on average equity were 1.02% and 13.50% for the current six month period compared to 1.09% and 12.50% for the six months ended June 30, 2002.

Stockholders' equity decreased $1.6 million from $24.2 million at December 31, 2002 to $22.7 million at June 30, 2003 on earnings of $1.5 million, a decrease in accumulated other comprehensive income of $119 thousand, while paying cash dividends of $555 thousand. On February 26, 2003 the corporation repurchased 118,000 shares (as restated for a two for one stock split) of outstanding common stock at a cost of $2.4 million.

Net Interest Income

Net interest income increased $758 thousand, or 16.9%, from $4.5 million for the six months ended June 30, 2002 to $5.3 million for the six-month period ended June 30, 2003. Total average earning assets outstanding grew from $243.1 million as of June 30, 2002 to $282.9 million as of June 30, 2003, and the net interest spread increased from 3.19% in 2002 to. 3.32% in 2003. The net interest margin on earning assets increased from 3.80% for the six months ended June 30, 2002 to 3.82% for the six month period ended June 30, 2003. As interest-bearing liabilities repriced faster than earning assets during a declining interest rate environment, the Company's yield on earning assets dropped 61 basis points from 6.94% for the six months ended June 30, 2002 to 6.33% for the six months ended June 30, 2003, while the average rate paid on interest bearing liabilities decreased 74 basis points from 3.75% to 3.01%; as a result the net interest spread increased 13 basis points. The following table shows the average balance sheet, interest rate spread and net interest margin for the six months ended June 30, 2003 and 2002.

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FIRST NATIONAL CORPORATION
AVERAGE BALANCES, INCOME AND EXPENSE, YIELDS AND RATES

	Six Months Ended Ju			
	2003			
	(000) Average Balance	Annual Income/ Expense	Yield/ Rate(3)	(000) Avera Balan
ASSETS				
Balances at correspondent banks - interest bearing	$1,480	$18	2.50%	$1,4
Securities:				
Taxable	46,710	973	4.20%	39,4
Tax-exempt (1)	6,505	244	7.56%	6,4
Total Securities	53,215	1,217	4.61%	45,9
Loans: (2)				
Taxable	221,889	7,560	6.87%	187,3
Tax-exempt (1)	1,747	64	7.36%	1,0
Total Loans	223,636	7,624	6.87%	188,3
Federal funds sold	4,541	25	1.12%	7,3
Total earning assets	282,872	8,884	6.33%	243,0
Less: allowance for loan losses	(2,278)			(2,03
Total non-earning assets	21,722			14,7
Total Assets	$302,316			$255,7

LIABILITIES AND STOCKHOLDERS' EQUITY				
Interest bearing deposits:				
Checking	$54,262	$553	2.06%	$22,7
Money market savings	9,197	43	0.93%	7,5
Regular savings	44,344	54	0.25%	56,9
Time deposits:				
Less than $100,000	67,445	1,384	4.14%	60,1
$100,000 and more	34,759	676	3.92%	28,4
Total interest bearing deposits	210,007	2,710	2.60%	175,7
Federal funds purchased	97	1	1.79%	
Long-term debt	26,594	817	6.20%	27,3
Total interest bearing liabilities	236,698	3,528	3.01%	203,1
Non-interest bearing liabilities:				
Demand deposits	40,416			28,4
Other liabilities	2,252			1,9
Total liabilities	279,366			233,5
Stockholders' equity	22,950			22,2
Total liabilities and stockholders' equity	$302,316			$255,7
Net interest income		$5,355		
Interest rate spread			3.32%	
Interest expense as a percent of average earning assets			2.52%	
Net interest margin			3.82%	

(1) Income and yields are reported on a taxable-equivalent basis assuming a federal tax rate of 34% in 2003 and 2002.
(2) Loans placed on a nonaccrual status are reflected in the balances.
(3) Annualized

Allowance for Loan Losses / Provision for Loan Loss Expense

The provision for loan losses is based upon management's estimate of the amount required to maintain an adequate allowance for loan losses reflective of the risks in the loan portfolio. For the six months ended June 30, 2003 charge-offs totaled $143 thousand compared to $130 thousand for the same period ended June 30, 2002. The provision for loan loss expense in the first six months of 2003 and 2002 was $330 thousand and $180 thousand, respectively. The total allowance for loan losses of $2.4 million at June 30, 2003 increased 9.6% from $2.2 million at December 31, 2002, and increased 16.1%, from $2.0 million at June 30, 2002. The increases in the total allowance for loan losses are reflective of charge-off activity, identified problem loans and the growth in loans as net loans outstanding increased $14.9 million, or 7.1%, from $210.4 million at December 31, 2002 to $225.4 million at June 30, 2003 and increased $31.3 million, or 16.2%, from $194.0 million at June 30, 2002. Identified problem loans increased from $3.9 million at June 30, 2002 to $7.7 million as of June 30, 2003.

Management feels that the allowance for loan losses is adequate. There can be no assurance, however, that additional provisions for loan losses will not be required in the future, including as a result of changes in the economic assumptions underlying management's estimates and judgments, adverse developments in the economy, on a national basis or in the Company's market area, or changes in the circumstances of particular borrowers.

The Company generates a monthly analysis of the allowance for loan losses, with the objective of quantifying portfolio risk into a dollar figure of inherent losses. In addition, internal loan reviews are performed on a regular basis. The determination of the allowance for loan losses is based on applying qualitative and quantitative factors to each category of loans along with any specific allowance for impaired and adversely classified loans within the particular category. The resulting sum is then combined to arrive at a total allowance for all categories. The Company assigns acceptable ranges of allowance factors to each loan category for consideration of the qualitative factors. The total allowance required changes as the various types and categories of loans change as a percentage of total loans and as specific allowances are required due to an increase in impaired and adversely classified loans.

The following schedule summarizes the changes in the allowance for loan losses:

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
	(in thousands of dol	
Allowance, at beginning of period	$ 2,162	$1
Provision charged against income	330	
Recoveries	20	
Losses charged to reserve	(143)	(
Net (charge-offs) recoveries	(123)	(
Allowance, at end of period	$ 2,369	$2
Ratio of annualized net charge-offs during the period to average loans outstanding for the period:	.11%	

Risk Elements and Non-performing Assets

Non-performing assets consist of non-accrual loans, impaired loans, restructured loans, and other real estate owned (foreclosed properties). The total non-performing assets and loans that are 90 days or more

past due and still accruing interest at June 30, 2003, did not change from the $1.4 million at December 31, 2002; however, they increased $783 thousand, or 123%, from $637 thousand at June 30, 2002.

Loans are placed in non-accrual status when in the opinion of management the collection of additional interest is unlikely or a specific loan meets the criteria for non-accrual status established by regulatory authorities. No interest is taken into income on non-accrual loans. A loan remains on non-accrual status until the loan is current as to both principal and interest or the borrower demonstrates the ability to pay and remain current, or both.

The ratio of non-performing assets and loans past due 90 days and still accruing to total assets decreased from 0.67% at December 31, 2002 to 0.63% at June 30, 2003, and increased from 0.33% at June 30, 2002. This ratio is expected to remain at its low level relative to the Company's peers; however it may increase from its current level. This expectation is based on identified problem loans on June 30, 2003. As of June 30, 2003, there were $7.7 million of loans for which management has identified risk factors which could impair repayment in accordance with their terms, compared to $3.1 million at December 31, 2002. These loans are mostly for commercial business purposes, are currently performing and generally are well-secured.

Non-performing assets consist of the following:

	June 30, 2003	June 30, 2002
	(In Thousands of Dollars)	
Non-accrual loans	$ 588	$ 109
Impaired loans	116	37
Total non-performing assets	704	146
Loans past due 90 days and still Accruing	716	491
Total non-performing assets and loans past due 90 days and still accruing	$1,420	$ 637
As a percentage of net loans	0.63%	0.33%
As a percentage of total assets	0.44%	0.23%

Non-Interest Income

Non-interest income increased $685 thousand, or 66.4%, from $1.0 million for the six months ended June 30, 2002 to $1.7 million for the same period ended June 30, 2003. Service charges and other fees grew $616 thousand, or 125.5%, from $491 thousand for the six months ended June 30, 2002 to $1.1 million for the current six month period due to overall growth in deposit accounts and the installation of an overdraft privilege program.

Non-Interest Expense

For the six months ended June 30, 2003, non-interest expense increased $1.0 million, or 30.3%, compared to the same period in 2002.

Salaries and employee benefits have increased $596 thousand for the six-month period ended June 30, 2003, primarily as a result of additional employees. Other operating expense increases of $239 thousand for the six months ended June 30 were up 24.4% due mostly to higher costs associated with the increased number of deposit accounts. As a percentage of total revenue sources (tax equivalent) net interest and

non-interest income) non-interest expense increased from 59.3% for the six months ended June 30, 2002 to 61.3% for the same period in 2003.

Provision for Income Taxes

The Company's income tax provisions are adjusted for non-deductible expenses and non-taxable interest after applying the U.S. federal income tax rate of 34%. Provision for income taxes totaled $763 thousand and $638 thousand for the six months ended June 30, 2003 and 2002, respectively.

Capital

The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, and changing competitive conditions and economic forces. The adequacy of the Company's capital is reviewed by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

The capital position of the Bank continues to meet regulatory requirements. The primary indicators relied on by bank regulators in measuring the capital position are the Tier 1 risk-based capital, total risk-based capital, and leverage ratios. Tier 1 capital consists of common stockholders' equity less goodwill. Total risk-based capital consists of Tier 1 capital and the allowance for loan losses. Risk-based capital ratios are calculated with reference to risk-weighted assets. The leverage ratio compares Tier 1 capital to total average assets for the most recent quarter end. The Bank's Tier 1 risk-based capital ratio was 10.32% at June 30, 2003, compared to 10.35% at December 31, 2002. The total risk-based capital ratio was 11.32% at June 30, 2003, compared to 11.33% at December 31, 2002. The Bank's leverage ratio was 7.86% at June 30, 2003 compared to 7.81% at December 31, 2002. Based on these ratios, the Bank is considered "well capitalized" under regulatory prompt corrective action guidelines. The Company's Tier 1 risk-based capital ratio, total risk-based capital ratio, and leverage ratio was 10.40%, 11.42% and 7.97%, respectively, at June 30, 2003.

Recent Accounting Pronouncements

In April 2003, the Financial Accounting Standards Board issued Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts(collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement is effective for contracts entered into or modified after June 30, 2003 and is not expected to have an impact on the Company's consolidated financial statements.

In May 2003, the Financial Accounting Standards Board issued Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of nonpublic entities. Adoption of the Statement did not result in an impact on the Company's consolidated financial statements.

Repurchase of Common Stock

On February 25, 2003 the corporation purchased and retired 118,000 (as restated for two for one split) shares of outstanding common stock of the corporation. This purchase was approved by the Board of Directors at the February 19, 2003 meeting of the board.

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Stock Split

On April 16, 2003 the Board of Directors of First National Corporation declared a two for one stock split of the corporation's common stock, including authorized and unissued shares. Both 2003 and 2002 financial statements have been restated to reflect the stock split. The stock split was payable on May 30, 2003 to shareholders of record April 30, 2003. After the stock split was completed, the corporation had 4 million shares of common stock authorized and 1,462,062 shares outstanding at a par value of $2.50 per share.

ITEM 3. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on that evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There were no significant changes in our internal controls or in other factors that could materially affect, or are reasonably likely to materially affect, these controls subsequent to the date of their evaluation.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Reconciliation of Non-GAAP Measures

The net interest margin and efficiency ratios are presented on a fully taxable-equivalent (FTE) and annualized basis. The FTE basis adjusts for the tax-favored status of income from certain loans and investments. Management believes this measure to be the preferred industry measurement of net interest income and provides a relevant comparison between taxable and non-taxable investments. The efficiency ratio is measured by dividing noninterest expenses by the sum of net interest income on a FTE basis and non-interest income. Management excludes gains and losses from sales of investment securities when computing the efficiency ratio because of the uncertainty as to timing and amount of gain or loss to be recognized.

	For the 6 Months Ended June 30,		For the 3 Mo June
	2003	2002	2003
	(Dollars in thousands)		
Net interest income	$ 5,251	$ 4,493	$ 2,726
Taxable-equivalent adjustment	104	93	57
Net interest income--taxable equivalent	$ 5,355	$ 4,586	$ 2,783
Efficiency ratio	61.49 %	60.48 %	61.79 %
Impact of excluding securities gains and losses	0.14	1.22	0.00
Adjusted efficiency ratio	61.35 %	59.26 %	61.79 %

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As of June 30, 2003 neither the Company nor the Bank was a party to any legal proceedings other than routine litigation that is incidental to its business.

Item 2. Changes in Securities and Use of Proceeds
None

Item 3. Defaults Upon Senior Securities
None

Item 4. Submission of Matters to a Vote of Security Holders

a) The Bank held its annual shareholders meeting on April 1, 2003.

b) The following Directors were elected:

Douglas C. Arthur	Charles E. Maddox Jr.
Noel M. Borden	John K. Marlow
Byron A. Brill	W. Allen Nicholls
Elizabeth H. Cottrell	Henry L. Shirkey
James A. Davis	Alson H. Smith, Jr.
Christopher E. French	Harry S. Smith

James R. Wilkins, III

c) The following matters were voted on during the annual shareholders meeting:

Votes were cast in the election of Directors as follows:

	FOR	WITHHELD
Douglas C. Arthur	602,568	11,720
Noel M. Borden	600,492	13,796
Byron A. Brill	602,148	12,140
Elizabeth H. Cottrell	602,566	11,722
James A. Davis	597,901	16,387
Christopher E. French	602,223	12,065
Charles E. Maddox, Jr	600,861	13,427
John K. Marlow	602,555	11,733
W. Allen Nicholls	602,568	11,720
Henry L. Shirkey	601,777	12,511
Alson H. Smith,Jr	602,197	12,091
Harry S. Smith	602,568	11,720
James R. Wilkins, III	602,148	12,140

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.

(b) Form 8-K

The Company filed a Current Report of Form 8-K with the Securities and Exchange Commission on April 30, 2003. The Form 8-K reported items 5, 7 and 12 (under item 9) and attached as exhibits and incoporated by reference two press releases, one of which announced a two-for-one stock split, and the other the Company's financial results for the quarter ended March 31, 2003.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 12, 2003 BY /s/ Harry S. Smith

Harry S. Smith, President & CEO

Date: August 12, 2003 BY /s/ Stephen C. Pettit

Stephen C. Pettit, Senior Vice President
& Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.