

NEW PEOPLES BANKSHARES INC  
Form 10-Q  
May 10, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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**x** Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2006

**..** 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: 000-33411

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**NEW PEOPLES BANKSHARES, INC.**

(Exact name of registrant as specified in its charter)

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Virginia  
(State or other jurisdiction of  
incorporation or organization)  
  
67 Commerce Drive  
Honaker, Virginia  
(Address of principal executive offices)

(276) 873-7000

(Registrant's telephone number, including area code)

31-1804543  
(I.R.S. Employer  
Identification No.)  
  
24260  
(Zip Code)

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n/a

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

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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:

7,647,747 shares of common stock, par value \$2.00 per share, outstanding as of April 19, 2006

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**Table of Contents****Part I Financial Information****Item 1 Financial Statements****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

|  | 2006         | 2005         |
|--|--------------|--------------|
| <b>INTEREST AND DIVIDEND INCOME</b>                        |              |              |
| Loans including fees                                       | \$ 8,915     | \$ 6,642     |
| Federal funds sold   | 26           | 23           |
| Investments  | 65           | 56           |
| <b>Total Interest and Dividend Income</b>                  | <b>9,006</b> | <b>6,721</b> |
| <b>INTEREST EXPENSE</b>                                    |              |              |
| Deposits   |              |              |
| Demand   | 36           | 32           |
| Savings  | 124          | 110          |
| Time deposits  | 3,309        | 1,837        |
| Interest on FHLB Advances                                  | 135          |              |
| Interest on Trust Preferred Securities                     | 222          | 152          |
| <b>Total Interest Expense</b>                              | <b>3,826</b> | <b>2,131</b> |
| <b>NET INTEREST INCOME</b>                                 | <b>5,180</b> | <b>4,590</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                           | <b>312</b>   | <b>320</b>   |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b> | <b>4,868</b> | <b>4,270</b> |
| <b>NONINTEREST INCOME</b>                                  |              |              |
| Service charges  | 452          | 317          |
| Fees, commissions and other income                         | 223          | 209          |
| Life insurance investment income                           | 99           | 96           |
| <b>Total Noninterest Income</b>                            | <b>774</b>   | <b>622</b>   |
| <b>NONINTEREST EXPENSES</b>                                |              |              |
| Salaries and employee benefits                             | 2,681        | 2,354        |
| Occupancy expense  | 666          | 584          |
| Other real estate  | 3            | 12           |
| Other operating expenses                                   | 1,168        | 959          |
| <b>Total Noninterest Expenses</b>                          | <b>4,518</b> | <b>3,909</b> |

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|  |           |           |
|--|-----------|-----------|
| <b>INCOME BEFORE INCOME TAXES</b>              | 1,124     | 983       |
| <b>INCOME TAX EXPENSE</b>                      | 307       | 295       |
| <b>NET INCOME</b>                              | \$ 817    | \$ 688    |
| <b>Earnings Per Share</b>                      |           |           |
| Basic  | \$ .11    | \$ .09    |
| Fully Diluted                                  | \$ .10    | \$ .09    |
| <b>Average Weighted Shares of Common Stock</b> |           |           |
| Basic  | 7,623,365 | 7,601,079 |
| Fully Diluted                                  | 7,838,923 | 7,802,017 |

The accompanying notes are an integral part of this statement.

**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED BALANCE SHEETS**

(IN THOUSANDS EXCEPT SHARE DATA)

|  | March 31,<br>2006<br>(Unaudited) | December 31,<br>2005<br>(Audited) |
|--|----------------------------------|-----------------------------------|
| <b>ASSETS</b>  |                                  |                                   |
| Cash and due from banks  | \$ 16,184                        | \$ 15,728                         |
| Federal funds sold   | 75                               | 2,922                             |
| Total Cash and Cash Equivalents  | 16,259                           | 18,650                            |
| <b>Investment Securities</b>   |                                  |                                   |
| Available-for-sale   | 3,587                            | 6,163                             |
| Loans receivable   | 490,447                          | 468,045                           |
| Allowance for loan losses  | (4,229)                          | (3,943)                           |
| Net Loans  | 486,218                          | 464,102                           |
| Bank premises and equipment, net   | 23,749                           | 22,046                            |
| Equity securities (restricted)   | 2,748                            | 2,273                             |
| Other real estate owned  | 1,273                            | 1,396                             |
| Accrued interest receivable  | 3,193                            | 3,005                             |
| Life insurance investments   | 9,115                            | 9,031                             |
| Other assets   | 1,501                            | 1,104                             |
| Total Assets   | \$ 547,643                       | \$ 527,770                        |
| <b>LIABILITIES</b>   |                                  |                                   |
| Deposits:  |                                  |                                   |
| Demand deposits:   |                                  |                                   |
| Noninterest bearing  | \$ 69,137                        | \$ 59,921                         |
| Interest-bearing   | 19,870                           | 19,845                            |
| Savings deposits   | 45,394                           | 44,778                            |
| Time deposits  | 342,451                          | 338,148                           |
| Total Deposits   | 476,852                          | 462,692                           |
| Federal Home Loan Bank advances  | 15,825                           | 11,570                            |
| Accrued interest payable   | 1,612                            | 1,558                             |
| Accrued expenses and other liabilities   | 2,133                            | 1,645                             |
| Trust preferred securities   | 11,341                           | 11,341                            |
| Total Liabilities  | 507,763                          | 488,806                           |
| <b>STOCKHOLDERS EQUITY</b>   |                                  |                                   |
| Common stock - \$2.00 par value; 12,000,000 shares authorized; 7,631,147 and 7,619,355 shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively | 15,262                           | 15,239                            |
| Additional paid-in-capital   | 21,332                           | 21,265                            |
| Retained earnings  | 3,292                            | 2,475                             |
| Accumulated other comprehensive income   | (6)                              | (15)                              |

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|   |            |            |
|---|------------|------------|
| Total Stockholders Equity                 | 39,880     | 38,964     |
| Total Liabilities and Stockholders Equity | \$ 547,643 | \$ 527,770 |

The accompanying notes are an integral part of this statement.

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## NEW PEOPLES BANKSHARES, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

## FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005

(IN THOUSANDS INCLUDING SHARE DATA)

(UNAUDITED)

|   | Shares<br>of<br>Common<br>Stock | Common<br>Stock | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accum-<br>ulated<br>Other<br>Compre-<br>hensive<br>Income<br>(Loss) | Total<br>Shareholders<br>Equity | Compre-<br>hensive<br>Income<br>(Loss) |
|---|---------------------------------|-----------------|----------------------------------|----------------------|---|---------------------------------|--|
| Balance, December 31, 2004  | 6,910                           | \$ 13,820       | \$ 13,118                        | \$ 9,177             | \$ (17)   | \$ 36,098                       | \$ 3,237                               |
| Net Income  |                                 |                 |                                  | 688                  |   | 688                             | \$ 688                                 |
| Unrealized loss on available-for-sale securities, net of taxes of \$5 |                                 |                 |                                  |                      | (10)  | (10)                            | (10)                                   |
| Stock Options Exercised   |                                 |                 | 1                                |                      |   | 1                               |  |
| Balance, March 31, 2005   | 6,910                           | \$ 13,820       | \$ 13,119                        | \$ 9,865             | \$ (27)   | \$ 36,777                       | \$ 678                                 |
| Balance, December 31, 2005  | 7,619                           | \$ 15,239       | \$ 21,265                        | \$ 2,475             | \$ (15)   | \$ 38,964                       | \$ 2,725                               |
| Net Income  |                                 |                 |                                  | 817                  |   | 817                             | \$ 817                                 |
| Unrealized gain on available-for-sale securities, net of tax of \$3   |                                 |                 |                                  |                      | 9   | 9                               | 9                                      |
| Stock Options Exercised   | 12                              | 23              | 67                               |                      |   | 90                              |  |
| Balance, March 31, 2006   | 7,631                           | \$ 15,262       | \$ 21,332                        | \$ 3,292             | \$ (6)  | \$ 39,880                       | \$ 826                                 |

The accompanying notes are an integral part of this statement.



**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005**

(IN THOUSANDS)

(UNAUDITED)

|   | 2006             | 2005             |
|---|------------------|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                  |                  |
| Net income  | \$ 817           | \$ 688           |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                  |
| Depreciation  | 529              | 463              |
| Provision for loan losses   | 312              | 320              |
| Income (less expenses) on life insurance  | (84)             | (83)             |
| Loss on sale of foreclosed real estate  | 3                | 12               |
| Amortization (Accretion) of bond premiums   | (11)             | 8                |
| Net change in:  |                  |                  |
| Interest receivable   | (188)            | (123)            |
| Other assets  | (397)            | (266)            |
| Accrued expenses and other liabilities  | 542              | 203              |
| <b>Net Cash Provided by Operating Activities</b>                                  | <b>1,523</b>     | <b>1,222</b>     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                  |                  |
| Net increase in loans   | (22,428)         | (19,350)         |
| Proceeds from sale and maturities of securities available-for-sale                | 2,596            |                  |
| Purchase of Federal Reserve Bank stock  | (75)             |                  |
| Purchase of Federal Home Loan Bank stock  | (400)            | (363)            |
| Payments for the purchase of property   | (2,232)          | (885)            |
| Proceeds from sale of other real estate owned                                     | 120              | 42               |
| <b>Net Cash Used in Investing Activities</b>                                      | <b>(22,419)</b>  | <b>(20,556)</b>  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |                  |                  |
| Common stock options exercised  | 90               | 1                |
| Proceeds from Federal Home Loan Bank advances                                     | 4,255            | 3,688            |
| Net change in:  |                  |                  |
| Demand and savings deposits   | 9,857            | 5,952            |
| Time deposits   | 4,303            | 6,686            |
| <b>Net Cash Provided by Financing Activities</b>                                  | <b>18,505</b>    | <b>16,327</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b>                       | <b>(2,391)</b>   | <b>(3,007)</b>   |
| Cash and Cash Equivalents, Beginning of Period                                    | 18,650           | 17,405           |
| <b>Cash and Cash Equivalents, End of Period</b>                                   | <b>\$ 16,259</b> | <b>\$ 14,398</b> |
| Supplemental Disclosure of Cash Paid During the Period for:                       |                  |                  |
| Interest  | \$ 3,881         | \$ 2,035         |

The accompanying notes are an integral part of this statement.



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1 NATURE OF OPERATIONS:**

New Peoples Bankshares, Inc. ( the Company ) is a financial holding company whose principal activity is the ownership and management of a community bank. New Peoples Bank, Inc. ( the Bank ) was organized and incorporated under the laws of the Commonwealth of Virginia on December 9, 1997. The Bank commenced operations on October 28, 1998, after receiving regulatory approval. As a state chartered bank, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve Bank. In addition, as a member of the Federal Reserve System, the Bank is also subject to regulation by the Board of Governors of the Federal Reserve System. The Bank provides general banking services to individuals, small and medium size businesses and the professional community of southwestern Virginia, southern West Virginia, and eastern Tennessee. On June 9, 2003, the Company formed two wholly owned subsidiaries, NPB Financial Services, Inc. and NPB Web Services, Inc. On July 7, 2004 the Company established NPB Capital Trust I for the purpose of issuing trust preferred securities.

**NOTE 2 ACCOUNTING PRINCIPLES:**

The financial statements conform to U. S. generally accepted accounting principles and to general industry practices. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position at March 31, 2006, and the results of operations for the three month periods ended March 31, 2006 and 2005. The notes included herein should be read in conjunction with the notes to financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The results of operations for the three month periods ended March 31, 2006 and 2005 are not necessarily indicative of the results to be expected for the full year.

**NOTE 3 ACCOUNTING CHANGES:**

In December 1986, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. As permitted, the Company adopted the provisions of this Statement for lending transactions entered into and commitments granted on or after January 1, 2005.

Accordingly, loan origination and commitment fees and certain direct loan origination costs are being deferred and the net amount amortized as an adjustment of the related loan s yield. The Company is generally amortizing these amounts over the contractual life of the related loans.

Before adopting Statement 91, the Company recognized loan origination and commitment fees as income in the period the loan or commitment was granted. The related costs associated with originating those loans and commitments were recognized in salary expense in the period incurred. At March 31, 2006, approximately \$253.9 million, or 51.77% of total loans included in the Company s financial statements, were accounted for under the prior policy.

The Company has a stock option plan for certain employees and directors which, prior to 2006, has been accounted for under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25. Effective January 1, 2006, using the modified prospective application transition method, the Company adopted FASB 123R, Share-Based Payment, which requires that grants under the plan be accounted for using the fair value method. Under FASB 123R, the fair value of options at the date of grant is estimated and that value is recorded as a charge to expense over the vesting period. Forfeitures are also projected at the date of grant. There were no options granted during the first quarters of 2005 or 2006 and, effective December 31, 2005 all outstanding options under the stock option plan were fully vested. Therefore there was no compensation expense reflected for the quarters ended March 31, 2006 and 2005 related to stock options.

**NOTE 4 INVESTMENT SECURITIES:**

The amortized cost and estimated fair value of securities at the dates indicated are as follows:

| (Dollars are in thousands) | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|----------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <b>March 31, 2006</b>      |                   |                              |                               |               |
| <u>Available for Sale</u>  |                   |                              |                               |               |
| U.S. Government Agencies   | \$ 3,596          | \$                           | \$ 9                          | \$ 3,587      |

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|                           |          |    |       |          |
|---------------------------|----------|----|-------|----------|
| Total Securities AFS      | \$ 3,596 | \$ | \$ 9  | \$ 3,587 |
| <b>December 31, 2005</b>  |          |    |       |          |
| <u>Available for Sale</u> |          |    |       |          |
| U.S. Government Agencies  | \$ 6,185 | \$ | \$ 22 | \$ 6,163 |
| Total Securities AFS      | \$ 6,185 | \$ | \$ 22 | \$ 6,163 |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****NOTE 4 INVESTMENT SECURITIES (Continued):**

At March 31, 2006 and December 31, 2005, all securities were classified as available for sale.

The Bank, as a member of the Federal Reserve Bank and the Federal Home Loan Bank, is required to hold stock in each. These equity securities are restricted from trading and are recorded at a cost of \$2.7 million and \$2.3 million at March 31, 2006 and December 31, 2005, respectively.

The amortized cost and fair value of investment securities at March 31, 2006, by contractual maturity, are shown in the following schedule. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| <b>(Dollars are in thousands)</b>           | <b>Amortized<br/>Cost</b> | <b>Fair<br/>Value</b> | <b>Weighted<br/>Average<br/>Yield</b> |
|---|---------------------------|-----------------------|---------------------------------------|
| <b><u>Securities Available for Sale</u></b> |                           |                       |                                       |
| Due in one year or less                     | \$ 3,095                  | \$ 3,088              | 3.73%                                 |
| Due after one year through five years       | 501                       | 499                   | 4.22%                                 |
| <b>Total</b>                                | <b>\$ 3,596</b>           | <b>\$ 3,587</b>       | <b>3.85%</b>                          |

Investment securities with a carrying value of \$3.2 million and \$3.0 million at March 31, 2006 and December 31, 2005, respectively, were pledged to secure public deposits and for other purposes required by law.

**NOTE 5 LOANS:**

Loans receivable outstanding are summarized as follows:

| <b>(Dollars are in thousands)</b>      | <b>March 31,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|---------------------------|------------------------------|
| Commercial, financial and agricultural | \$ 100,728                | \$ 93,987                    |
| Real estate - construction             | 29,921                    | 26,267                       |
| Real estate - mortgages                | 312,182                   | 301,740                      |
| Installment loans to individuals       | 47,616                    | 46,051                       |
| <b>Total Loans</b>                     | <b>\$ 490,447</b>         | <b>\$ 468,045</b>            |

The following is a summary of information at March 31, 2006 and December 31, 2005 pertaining to nonperforming assets:

| <b>(Dollars are in thousands)</b>                      | <b>March 31,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|---------------------------|------------------------------|
| <b>Principal:</b>                                      |                           |                              |
| Nonaccrual loans                                       | \$ 510                    | \$ 446                       |
| Other real estate owned                                | 1,273                     | 1,396                        |
| Loans past due 90 days or more still accruing interest | 96                        | 116                          |

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|                            |          |          |
|----------------------------|----------|----------|
| Total nonperforming assets | \$ 1,879 | \$ 1,958 |
|----------------------------|----------|----------|

**NOTE 6 ALLOWANCE FOR LOAN LOSSES:**

A summary of transactions in the allowance for loan losses are as follows:

| <b>(Dollars are in thousands)</b> | <b>For the Three Months Ended</b> |                           |
|-----------------------------------|-----------------------------------|---------------------------|
|                                   | <b>March 31,<br/>2006</b>         | <b>March 31,<br/>2005</b> |
| Balance, Beginning of Period      | \$ 3,943                          | \$ 3,090                  |
| Provision for loan losses         | 312                               | 320                       |
| Recoveries of loans charged off   | 3                                 | 7                         |
| Loans charged off                 | (29)                              | (56)                      |
| <b>Balance, End of Period</b>     | <b>\$ 4,229</b>                   | <b>\$ 3,361</b>           |
| Percentage of Loans               | 0.86%                             | 0.83%                     |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****NOTE 7 COMMON STOCK:**

During the first quarter of 2006, 11,792 options to purchase shares of common stock were exercised resulting in a \$90 thousand increase to capital. At March 31, 2006, the following exercisable options were outstanding.

| <b>Date of Grant</b> | <b>Outstanding</b> | <b>Exercise Price</b> |
|----------------------|--------------------|-----------------------|
| December 12, 2001    | 234,657            | \$ 6.82               |
| January 1, 2003      | 81,375             | \$ 9.09               |
| January 1, 2004      | 94,600             | \$ 9.09               |
| November 23, 2004    | 30,800             | \$ 12.28              |
| December 13, 2004    | 79,050             | \$ 12.28              |
| December 20, 2005    | 323,100            | \$ 15.00              |

**NOTE 8 EARNINGS PER SHARE:**

Basic earnings per share computations are based on the weighted average number of shares outstanding during each year. Dilutive earnings per share reflects the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate to outstanding options and are determined by the Treasury Method.

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

#### **Caution About Forward Looking Statements**

We make forward looking statements in this quarterly report that are subject to risks and uncertainties. These forward looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals. The words believes, expects, may, will, should, projects, contemplates, anticipates, forecasts, intends, or other similar terms are intended to identify forward looking statements.

These forward looking statements are subject to significant uncertainties because they are based upon or are affected by factors including the following: the ability to successfully manage our growth or implement our growth strategies if we are unable to identify attractive markets, locations or opportunities to expand in the future; maintaining capital and liquidity levels adequate to support our growth; maintaining cost controls and asset quality as we open or acquire new branches; reliance on our management team, including our ability to attract and retain key personnel; the successful management of interest rate risk; changes in general economic and business conditions in our market area; changes in interest rates and interest rate policies; risks inherent in making loans such as repayment risks and fluctuating collateral values; competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources; demand, development and acceptance of new products and services; problems with technology utilized by us; changing trends in customer profiles and behavior; and changes in banking and other laws and regulations applicable to us.

Because of these uncertainties, our actual future results may be materially different from the results indicated by these forward looking statements. In addition, our past results of operations do not necessarily indicate our future results.

#### **Overview**

For the first quarter of 2006, New Peoples Bankshares, Inc. (the Company), which is the parent company of New Peoples Bank, Inc. (the Bank), continued to grow to record levels. For the first quarter of 2006, total assets increased \$19.9 million from December 31, 2005, or 3.77% to \$547.6 million. Total loans grew \$22.4 million, or 4.79%, to \$490.4 million and total deposits increased to \$476.9 million, or 3.06%, at March 31, 2006, as compared to December 31, 2005.

Net income for the quarter ended March 31, 2006 was \$817 thousand, as compared to \$688 thousand for the same period ended March 31, 2005. Basic net income per share was \$.11 for the quarter ended March 31, 2006, as compared to \$.09 for the same period in 2005.

At the end of the first quarter of 2006, we opened a new branch office in Pound, Virginia. During the first week of April, we opened a new office in Esserville, Virginia. Additional branch locations are in development for opening in late 2006.

#### **Critical Accounting Policies**

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements. The most critical accounting policy relates to our provision for loan losses, which reflects the estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additional provisions could be required. For further discussion of the estimates used in determining the allowance for loan losses, we refer you to the section on Provision for Loan Losses below.

#### **Balance Sheet Changes**

At March 31, 2006, total assets increased to \$547.6 million, an increase of \$19.9 million, or 3.77%, over December 31, 2005. This is a result of continued growth at the existing branch locations.

Loan growth remains strong as total loans increased \$22.4 million, or 4.79% to \$490.4 million at March 31, 2006 from \$468.0 million at December 31, 2005. Asset quality remains strong as discussed in the section Provision for Loan Losses.

We had continued growth in deposits, which totaled \$476.9 million at March 31, 2006, an increase of \$14.2 million, or 3.06%, from \$462.7 million at December 31, 2005. The largest area of deposit growth was in demand deposits, which increased \$9.2 million, or 11.58%.





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Borrowings from the Federal Home Loan Bank increased \$4.3 million, or 36.78%, from \$11.6 million at year-end 2005 to \$15.8 million at March 31, 2006. These advances on our line of credit have been made to temporarily fund loan growth. We anticipate reducing these borrowings over the year 2006 as deposits grow in new and existing locations.

### **Net Interest Income, Net Interest Margin, and Interest Sensitivity**

During the first quarter of 2006, our net interest margin was 4.27%. This is a decrease as compared to 4.54% in the first quarter of 2005. The decrease in the net interest margin is due principally to interest rate increases imposed by the Federal Reserve.

At March 31, 2005, we had a negative cumulative gap rate sensitivity ratio of 28.28% for the one year re-pricing period, compared to a negative cumulative gap of 30.38% at December 31, 2005. This generally indicates that earnings would improve in a declining interest rate environment as liabilities re-price more quickly than assets. Conversely, earnings would probably decrease in periods during which interest rates are increasing. Interest rates continued to increase more quickly on our liabilities than our earning assets; consequently, the cost of funds increased at a faster pace than the yields on earning assets. The cost of funds as of March 31, 2006 was 3.57% as compared to 2.41% for the same period in 2005. Interest expense increased \$1.7 million, or 79.55%, from \$2.1 million in 2005 to \$3.8 million in 2006. The yield on earning assets increased to 7.42% from 6.65% as of March 31, 2006 and 2005, respectively. We continue to make adjustments to the repricing features of the assets and liabilities to maximize potential income.

Overall, net interest income increased \$590 thousand, or 12.85% to \$5.2 million as of March 31, 2006 as compared to \$4.6 million for the same period in 2005.

### **Provision for Loan Losses**

The provision for loan losses was \$312 thousand for the first quarter of 2006 compared with \$320 thousand for the same period in 2005. The allowance for loan losses was \$4.2 million at March 31, 2006 as compared to \$3.9 million at December 31, 2005. The ratio of the allowance for loan losses to total loans was .86% at March 31, 2005 and .84% at the end of 2005. Net loans charged off for the first quarter of 2006 remained low at \$26 thousand as compared to \$49 thousand for the first quarter of 2005.

The calculation of the allowance for loan losses is considered a critical accounting policy. The adequacy of the allowance for loan losses is based upon management's judgment and analysis. The following factors are evaluated in determining the adequacy of the allowance: risk characteristics of the loan portfolio, current and historical loss experience, concentrations and internal and external factors such as general economic conditions.

Certain risk factors exist in the Bank's loan portfolio. Since the Bank commenced operations in 1998, we have experienced significant loan growth each year. Although we have experienced lenders who are familiar with their customer base, some of the loans are too new to have exhibited signs of weakness. In addition, recent expansions into new markets increase credit risk. We consider these factors to create an element of higher risk in the loan portfolio.

It is our policy to stop accruing interest on a loan, and classify that loan as non-accrual under the following circumstances: (a) whenever we are advised by the borrower that scheduled principal payments or interest payments cannot be met, (b) when our best judgment indicates that payment in full of principal and interest can no longer be expected, or (c) when any loan or obligation becomes delinquent for 90 days unless it is both well secured and in the process of collection. Non-accrual loans did not have a significant impact on interest income in any of the periods presented. No loans are classified as troubled debt restructurings as defined by the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings. There are also no loans identified as potential problem loans. We do not have any commitments to lend additional funds to non-performing debtors.

A majority of our loans are collateralized by real estate located in our market area. Market values have been and remain stable. It is our policy to sufficiently collateralize loans to minimize loss exposures in case of default. The market area is somewhat diverse, but certain areas are more reliant upon agriculture and coal mining. As a result, increased risk of loan impairments is possible if these industries experience a significant downturn. However, we do not foresee this happening in the near future.

All internal and external factors are considered in determining the adequacy of the allowance for loan losses. We believe that the methodology used to calculate the allowance provides sufficiently for potential losses present at the end of the period. The evaluation of individual loans is performed by the internal loan review department. Loans are



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initially risk rated by the originating loan officer. If deteriorations in the financial condition of the borrower and the capacity to repay the debt occur, along with other factors, the loan may be downgraded. This is typically determined by either the loan officer or loan review personnel. Guidance for the evaluation is established by the regulatory authorities who periodically review the Bank's loan portfolio for compliance.

Due to the risk factors previously mentioned, all loans classified as other assets especially mentioned, substandard, doubtful and loss are individually reviewed for impairment. An evaluation is made to determine if the collateral is sufficient for each of these credits. If an exposure exists, a specific allowance is directly made for the amount of the potential loss. Such specific allowances totaled \$46 thousand at March 31, 2006, or 1.09% of the allowance for loan losses, as compared to \$52 thousand at December 31, 2005, or 1.32% of the allowance for loan losses. In addition, for these classified credits that are adequately secured by collateral, a general allocation is also made to allow for any inherent risks. As we continue to evaluate the loan portfolio and the risk factors present, we will continue to designate pools as deemed appropriate. We calculate an allowance for the remaining loan portfolio based upon an estimated loan loss percentage. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. As economic conditions and performance of our loans change, it is possible that future increases may need to be made to the allowance for loan losses.

### **Noninterest Income**

Noninterest income increased to \$774 thousand in the first quarter of 2006 from \$622 thousand in 2005. The \$152 thousand, or 24.45%, increase is primarily related to an increase in overdraft fees on deposit accounts that we implemented during 2005. Noninterest income as a percentage of average assets (annualized) was 0.58% and 0.55% as of March 31, 2006 and 2005, respectively.

### **Noninterest Expense**

Noninterest expense totaled \$4.5 million for the first quarter of 2006 as compared to \$3.9 million for the same period in 2005. The increase was largely due to additional staffing and expenses associated with the new branches opened and the general growth in operations, as salaries and benefits increased from \$2.4 million to \$2.7 million. We expect noninterest expense to continue to increase, on a year-over-year basis, for the remainder of 2006 as we realize a full-year's effect of staffing for the new branches opened during 2005 and the new branches in Esserville and Pound, Virginia. Noninterest expense as a percentage of average assets (annualized) decreased to 3.37% for the first quarter of 2006 as compared to 3.49% for the same period in 2005. Noninterest expense in the future will depend on our growth and the number of new branch locations.

Greater efficiencies will result as we maximize the performance of our branches. Our efficiency ratio, which is defined as noninterest expense divided by the sum of net interest income plus noninterest income, was 75.88% for the first quarter of 2006 as compared to 74.94% for the same period in 2005. This was slightly higher as the result of additional staffing during the first quarter of 2006 and a lower net interest margin during the first quarter of 2006. The ratio of assets to full-time equivalent employees was \$2.0 million at both March 31, 2006 and December 31, 2005.

### **Capital**

Total capital at the end of the first quarter of 2006 was \$39.9 million as compared to \$39.0 million at the end of December 31, 2005. The increase is primarily the result of retained earnings for the quarter. Capital as a percentage of total assets was 7.28% at March 31, 2006 as compared to 7.38% at December 31, 2005, both of which exceeded regulatory requirements.

No cash dividends have been paid historically and none are anticipated in the foreseeable future. The Company's strategic plan is to continue growing. To accommodate this growth and have sufficient capital, earnings will need to be retained.

### **Liquidity**

At March 31, 2006 and December 31, 2005, we had liquid assets in the form of cash, due from banks and federal funds sold of approximately \$16.3 and \$18.7 million, respectively. At March 31, 2006, all of our investments are classified as available-for-sale providing an additional source of liquidity in the amount of \$400 thousand, which is net of those securities pledged as collateral for public funds.

Our loan to deposit ratio was 102.85% at March 31, 2006 and 101.16% at year end 2005. We anticipate this ratio to decrease in the near future as new deposits are generated from the newer branches with promotional rates. We can lower the ratio as management deems appropriate by managing the rate of growth in our loan portfolio. This can be done by changing interest rates charged or limiting the amount of new loans approved.



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At March 31, 2006, we had borrowings from the Federal Home Loan Bank totaling \$15.8 million as compared to \$11.6 million at December 31, 2005. These borrowings are overnight and subject to interest rate changes daily. These borrowings are advanced from a \$79.1 million line of credit which is secured by a blanket lien on residential real estate loans.

In the event we need additional funds, we have the ability to purchase federal funds under established lines of credit totaling \$20.4 million.

Additional liquidity is expected to be provided by the future growth that management expects in deposit accounts and from loan repayments. We believe that this future growth will result from an increase in market share in our targeted trade area. At the end of the first quarter of 2006 and the first week of the second quarter of 2006, we opened two new offices in Esserville and Pound, Virginia. We expect to raise additional deposits at these offices that will reduce borrowings. Deposit interest rates have been increased at various branch locations to spur deposit growth during the second quarter of 2006.

With the lines of credit available and the anticipated deposit growth from new and existing branches, we believe we have adequate liquidity to meet our requirements and needs for the foreseeable future.

### **Off Balance Sheet Items**

There have been no material changes to the off-balance sheet items disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2005.

### **Contractual Obligations**

There have been no material changes outside the ordinary course of business to the contractual obligations disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2005.

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

There have been no material changes in market risks faced by the Company since December 31, 2005. For information regarding the Company's market risk, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

### **Item 4. Controls and Procedures**

We have carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer (our CEO) and our Senior Vice President and Chief Financial Officer (our CFO), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that our disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Company to disclose material information otherwise required to be set forth in our periodic reports.

Our management is also responsible for establishing and maintaining adequate internal controls over financial reporting and control of our assets to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. No changes in our internal control over financial reporting or control of assets occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting or control over our assets.

## **Part II Other Information**

### **Item 1. Legal Proceedings**

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In the course of our operations, we may become a party to legal proceedings. We are not aware of any material pending or threatened legal proceedings.

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**Item 1A. Risk Factors**

There have been no material changes in the risk factors faced by the Company from those disclosed in the Company's Form 10-K for the year ended December 31, 2005.

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

Not Applicable

**Item 3. Defaults Upon Senior Securities**

Not Applicable

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

Not Applicable

**Item 5. Other Information**

Not Applicable

**Item 6. Exhibits**

The following exhibits are filed as part of this Form 10-Q, and this list includes the exhibit index:

**No. Description**

- 3.1 Amended Articles of Incorporation of Registrant (restated in electronic format as of September 30, 2003) (incorporated by reference to Exhibit 3.1 to Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004).
- 3.2 Bylaws of Registrant (restated in electronic format as of March 17, 2004) (incorporated by reference to Exhibit 3.1 to Form 8-K filed April 15, 2004).
- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 2004.
- 31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 2004.
- 32 Certification by Chief Executive Officer and Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.



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**SIGNATURES**

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

**NEW PEOPLES BANKSHARES, INC.  
(Registrant)**

By: /s/ KENNETH D. HART  
Kenneth D. Hart  
President and Chief Executive Officer  
Date: May 10, 2006

By: /s/ C. TODD ASBURY  
C. Todd Asbury  
Senior Vice President and Chief Financial Officer  
Date: May 10, 2006