

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

**FORM 10-Q**

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

For the Quarterly Period Ended September 30, 2002

Commission File No. 0-20293

**UNION BANKSHARES CORPORATION**

(Exact name of registrant as specified in its charter)

**Virginia**  
(State of Incorporation)

**54-1598552**  
(I.R.S. Employer Identification No.)

**212 North Main Street  
P.O. Box 446  
Bowling Green, Virginia 22427**  
(Address of principal executive offices)

**(804) 633-5031**  
(Registrant's telephone number)

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE**

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: COMMON STOCK, \$2 PAR VALUE**

Indicate by checkmark 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

As of October 28, 2002, Union Bankshares Corporation had 7,600,817 shares of Common Stock outstanding.

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FORM 10-Q  
September 30, 2002

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**PART 1 - FINANCIAL INFORMATION**  
**Item 1. Financial Statements**

**UNION BANKSHARES CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
*(dollars in thousands, except share information)*

	September 30, 2002	December 31, 2001
	(Unaudited)	
<b>ASSETS</b>		
<b>Cash and cash equivalents:</b>		
Cash and due from banks	\$ 27,621	\$ 28,769
Interest-bearing deposits in other banks	4,618	462
Money market investments	199	2,023
Federal funds sold	4,964	7,661
<b>Total cash and cash equivalents</b>	<b>37,402</b>	<b>38,915</b>
<b>Securities available for sale, at fair value</b>	<b>265,601</b>	<b>257,062</b>
<b>Loans held for sale</b>	<b>39,744</b>	<b>43,485</b>
<b>Loans, net of unearned income</b>	<b>686,405</b>	<b>600,164</b>
Less allowance for loan losses	8,946	7,336
<b>Net loans</b>	<b>677,459</b>	<b>592,828</b>
<b>Bank premises and equipment, net</b>	<b>21,587</b>	<b>19,191</b>
<b>Other real estate owned</b>	<b>781</b>	<b>768</b>
<b>Other assets</b>	<b>27,797</b>	<b>30,848</b>
<b>Total assets</b>	<b>\$ 1,070,371</b>	<b>\$ 983,097</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Noninterest-bearing demand deposits</b>	<b>\$ 131,018</b>	<b>\$ 110,913</b>
<b>Interest-bearing deposits:</b>		
NOW accounts	120,887	112,940
Money market accounts	83,607	79,176
Savings accounts	81,453	72,897
Time deposits of \$100,000 and over	137,675	133,629
Other time deposits	297,483	274,529
<b>Total interest-bearing deposits</b>	<b>721,105</b>	<b>673,171</b>
<b>Total deposits</b>	<b>852,123</b>	<b>784,084</b>
<b>Securities sold under agreements to repurchase</b>	<b>39,919</b>	<b>41,083</b>
<b>Long-term borrowings</b>	<b>62,010</b>	<b>62,731</b>
<b>Other liabilities</b>	<b>11,997</b>	<b>6,220</b>
<b>Total liabilities</b>	<b>966,049</b>	<b>894,118</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Common stock, \$2 par value. Authorized 24,000,000 shares; issued and outstanding, 7,560,817, and 7,525,912 shares, respectively	15,122	15,052
Surplus	1,024	446
Retained earnings	80,057	71,419
Accumulated other comprehensive income	8,119	2,062
<b>Total stockholders' equity</b>	<b>104,322</b>	<b>88,979</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,070,371</b>	<b>\$ 983,097</b>

See accompanying notes to consolidated financial statements.

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**UNION BANKSHARES CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**  
(dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
<b>Interest and dividend income:</b>				
Interest and fees on loans	\$ 12,827	\$ 12,831	\$ 37,496	\$ 39,001
Interest on Federal funds sold	58	196	151	323
Interest on interest-bearing deposits in other banks	5	10	12	28
Interest on money market investments	1	—	12	
Interest and dividends on securities:				
Taxable	2,396	2,296	7,270	6,715
Nontaxable	1,154	1,144	3,486	3,502
<b>Total interest and dividend income</b>	<b>16,441</b>	<b>16,477</b>	<b>48,427</b>	<b>49,569</b>
<b>Interest expense:</b>				
Interest on deposits	5,048	6,786	15,297	21,051
Interest on short-term borrowings	136	306	359	1,037
Interest on long-term borrowings	930	991	2,765	3,192
<b>Total interest expense</b>	<b>6,114</b>	<b>8,083</b>	<b>18,421</b>	<b>25,280</b>
<b>Net interest income</b>	<b>10,327</b>	<b>8,394</b>	<b>30,006</b>	<b>24,289</b>
<b>Provision for loan losses</b>	<b>650</b>	<b>445</b>	<b>2,219</b>	<b>1,270</b>
<b>Net interest income after provision for loan losses</b>	<b>9,677</b>	<b>7,949</b>	<b>27,787</b>	<b>23,019</b>
<b>Noninterest income:</b>				
Service charges on deposit accounts	1,079	881	2,939	2,753
Other service charges, commissions and fees	657	636	1,962	1,867
Gains (losses) on securities transactions, net	1	95	(160)	125
Gains on sales of loans	2,722	2,360	6,936	6,291
Gains (losses) on sales of other real estate owned and bank premises, net	77	(15)	159	69
Other operating income	188	110	548	664
<b>Total noninterest income</b>	<b>4,724</b>	<b>4,067</b>	<b>12,384</b>	<b>11,769</b>
<b>Noninterest expenses:</b>				
Salaries and benefits	5,510	4,974	15,655	14,247
Occupancy expenses	589	553	1,697	1,614
Furniture and equipment expenses	639	700	1,993	2,128
Other operating expenses	2,329	1,875	7,020	5,842
<b>Total noninterest expenses</b>	<b>9,067</b>	<b>8,102</b>	<b>26,365</b>	<b>23,831</b>
Income before income taxes	5,334	3,914	13,806	10,957
Income tax expense	1,323	877	3,284	2,363
<b>Net income</b>	<b>\$ 4,011</b>	<b>\$ 3,037</b>	<b>\$ 10,522</b>	<b>\$ 8,594</b>
<b>Basic net income per share</b>	<b>\$ 0.53</b>	<b>\$ 0.40</b>	<b>\$ 1.39</b>	<b>\$ 1.14</b>
<b>Diluted net income per share</b>	<b>\$ 0.52</b>	<b>\$ 0.40</b>	<b>\$ 1.38</b>	<b>\$ 1.14</b>

See accompanying notes to consolidated financial statements.

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**UNION BANKSHARES CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001**  
*(dollars in thousands)*

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Total
<b>Balance - December 31, 2000</b>	\$ 15,033	\$ 403	\$ 63,201	\$ (285)		\$ 78,352
Comprehensive income:						
Net income - for nine months ended September 30, 2001			8,594		\$ 8,594	8,594
Unrealized holding gains arising during the period (net of tax, \$2,361)					4,418	
Reclassification adjustment for gains included in net income (net of tax, \$43)					(82)	
Other comprehensive income (net of tax, \$2,318)				4,500	4,500	4,500
<b>Total comprehensive income</b>					<b>\$ 13,094</b>	
Cash dividends - 2001 (\$ .44 per share semi annually)			(1,658)			(1,658)
Issuance of common stock under Dividend Reinvestment Plan (12,930 shares)	26	168	—			194
Stock repurchased under Stock Repurchase Plan (31,250 shares)	(62)	(427)				(489)
Issuance of common stock in exchange for net assets in acquisition (19,606 shares)	39	192				231
<b>Balance - September 30, 2001 (Unaudited)</b>	<b>\$ 15,036</b>	<b>\$ 336</b>	<b>\$ 70,137</b>	<b>\$ 4,215</b>		<b>\$ 89,724</b>
<b>Balance - December 31, 2001</b>	<b>\$ 15,052</b>	<b>\$ 446</b>	<b>\$ 71,419</b>	<b>\$ 2,062</b>		<b>\$ 88,979</b>
Comprehensive income:						
Net income - for nine months ended September 30, 2002			10,522		\$ 10,522	10,522
Unrealized holding gains arising during the period (net of tax, \$3,066)					5,951	
Reclassification adjustment for loss included in net income (net of tax, \$54)					106	
Other comprehensive income (net of tax, \$3,120)				6,057	6,057	6,057
<b>Total comprehensive income</b>					<b>\$ 16,579</b>	
Cash dividends - 2002 (\$ .50 per share semi annually)			(1,884)			(1,884)
Issuance of common stock under Dividend Reinvestment Plan (9,549 shares)	19	196	—			215
Issuance of common stock under Incentive Stock Option Plan (8,200 shares)	17	83				100
Issuance of common stock in exchange for net assets in acquisition (17,156 shares)	34	299				333
<b>Balance - September 30, 2002 (Unaudited)</b>	<b>\$ 15,122</b>	<b>\$ 1,024</b>	<b>\$ 80,057</b>	<b>\$ 8,119</b>		<b>\$ 104,322</b>

See accompanying notes to consolidated financial statements.

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**UNION BANKSHARES CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows (Unaudited)**  
**Nine Months Ended September 30, 2002 and 2001**  
(dollars in thousands)

	2002	2001
<b>Operating activities:</b>		
Net income	\$ 10,522	\$ 8,594
Adjustments to reconcile net income to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation of bank premises and equipment	1,462	1,438
Amortization	1,416	996
Provision for loan losses	2,219	1,280
(Gains) losses on sales of securities available for sale	160	(125)
Gains on sales of other real estate owned and fixed assets, net	(159)	(69)
(Increase) decrease in loans held for sale	3,741	(10,912)
(Increase) decrease in other assets	(380)	480
Increase (decrease) in other liabilities	5,776	(192)
<b>Net cash and cash equivalents provided by operating activities</b>	<b>24,757</b>	<b>1,490</b>
<b>Investing activities:</b>		
Purchase of securities available for sale	(36,438)	(45,907)
Proceeds from sale of securities available for sale	6,280	1,556
Proceeds from maturities of securities available for sale	30,165	35,047
Net increase in loans	(87,329)	(16,449)
Purchases of bank premises and equipment	(4,254)	(519)
Proceeds from sales of bank premises and equipment	220	22
Proceeds from sales of other real estate owned	501	879
<b>Net cash and cash equivalents used in investing activities</b>	<b>(90,855)</b>	<b>(25,371)</b>
<b>Financing activities:</b>		
Net increase in noninterest-bearing deposits	20,105	8,487
Net increase in interest-bearing deposits	47,934	36,420
Net increase (decrease) in short-term borrowings	(1,164)	6,439
Net decrease in long-term borrowings	(721)	(10,843)
Issuance of common stock	315	194
Purchase of common stock	—	(489)
Cash dividends paid	(1,884)	(1,658)
<b>Net cash and cash equivalents provided by financing activities</b>	<b>64,585</b>	<b>38,550</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1,513)</b>	<b>14,669</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>38,915</b>	<b>22,869</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 37,402</b>	<b>\$ 37,538</b>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash payments for:		
Interest	\$ 18,657	\$ 25,540
Income taxes	\$ 3,292	\$ 1,942

See accompanying notes to consolidated financial statements.

**UNION BANKSHARES CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**  
**September 30, 2002**

**1. ACCOUNTING POLICIES**

The consolidated financial statements include the accounts of Union Bankshares Corporation and its subsidiaries (the "Company"). Significant intercompany accounts and transactions have been eliminated in consolidation.

Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of operations for each of the periods presented have been made. Operating results for the three and nine month periods ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's annual report on Form 10-K for the year ended December 31, 2001. Certain previously reported amounts have been reclassified to conform to current period presentation. These reclassifications are immaterial and had no effect on net income or stockholders' equity.

**2. ALLOWANCE FOR LOAN LOSSES**

The following summarizes activity in the allowance for loan losses for the nine months ended September 30, (in thousands):

	2002	2001
Balance, January 1	\$ 7,336	\$ 7,389
Provisions charged to operations	2,219	1,270
Recoveries credited to allowance	384	296
Loans charged off	(993)	(1,492)
Balance, September 30	<u>\$ 8,946</u>	<u>\$ 7,463</u>

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### 3. EARNINGS PER SHARE

Basic earnings per share (EPS) is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares outstanding attributable to stock options. At September 30, 2002 there were no stock options that were anti-dilutive. The following is a reconciliation of the components of the basic and diluted EPS computations for the three and the nine months ended September 30, 2002 and 2001.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
(In thousands except per share data)				
<b>Earnings per common share computation:</b>				
Net Income	\$ 4,011	\$ 3,037	\$ 10,522	\$ 8,594
Average common shares outstanding	7,560	7,524	7,550	7,526
<b>Earnings per common share</b>	<b>0.53</b>	<b>0.40</b>	<b>1.39</b>	<b>1.14</b>
<b>Diluted earnings per common share computation:</b>				
Net Income	4,011	3,037	10,522	8,594
Average common shares outstanding	7,560	7,524	7,550	7,526
Dilutive shares contingently issuable	74	20	64	17
Average diluted common shares outstanding	7,634	7,544	7,614	7,543
<b>Diluted earnings per common share</b>	<b>0.52</b>	<b>0.40</b>	<b>1.38</b>	<b>1.14</b>

### 4. SEGMENT REPORTING DISCLOSURES

Union Bankshares Corporation has two reportable segments: traditional full service community banking and mortgage loan origination. The community bank segment includes four banks, which provide loan, deposit, investment, and trust services to retail and commercial customers throughout their 31 retail locations in Virginia. The mortgage segment provides a variety of mortgage loan products principally in Virginia and Maryland. These loans are originated and sold primarily in the secondary market through purchase commitments from investors, which subject the Company to only de minimis risk.

Profit and loss is measured by net income after taxes including realized gains and losses on the Company's investment portfolio. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies of the Company. Intersegment transactions are recorded at cost and eliminated as part of the consolidation process.



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Both of the Company's reportable segments are service based. The mortgage business is a fee based business while the banks are driven principally by net interest income. The banks provide a distribution and referral network through their customers for the mortgage loan origination business. The mortgage segment offers a more limited network for the banks, due largely to the minimal degree of overlapping geographic markets.

The community bank segment provides the mortgage segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest. These transactions are eliminated in the consolidation process. A management fee for back room support services is charged to all subsidiaries and eliminated in the consolidation totals.

Information about reportable segments and reconciliation of such information to the consolidated financial statements for the three and nine months ended September 30, 2002 and 2001 follows:

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Union Bankshares Corporation  
Segment Report

	Community Banks	Mortgage	Elimination	Consolidated Totals
	(in thousands)			
<b>Three Months ended September 30, 2002</b>				
Net interest income	\$ 10,082	\$ 245	\$ —	\$ 10,327
Provision for loan losses	650	—	—	650
<b>Net interest income after provision for loan losses</b>	<b>9,432</b>	<b>245</b>	<b>—</b>	<b>9,677</b>
Noninterest income	2,046	2,722	(44)	4,724
Noninterest expenses	6,834	2,277	(44)	9,067
<b>Income before income taxes</b>	<b>4,644</b>	<b>690</b>	<b>—</b>	<b>5,334</b>
Income tax expense	1,088	235	—	1,323
<b>Net income</b>	<b>\$ 3,556</b>	<b>\$ 455</b>	<b>\$ —</b>	<b>\$ 4,011</b>
<b>Assets</b>	<b>\$ 1,065,167</b>	<b>\$ 42,723</b>	<b>\$ (36,519)</b>	<b>\$ 1,071,371</b>
<b>Three Months ended September 30, 2001</b>				
Net interest income	\$ 8,196	\$ 198	\$ —	\$ 8,394
Provision for loan losses	445	—	—	445
<b>Net interest income after provision for loan losses</b>	<b>7,751</b>	<b>198</b>	<b>—</b>	<b>7,949</b>
Noninterest income	1,744	2,363	(40)	4,067
Noninterest expenses	6,099	2,043	(40)	8,102
<b>Income before income taxes</b>	<b>3,396</b>	<b>518</b>	<b>—</b>	<b>3,914</b>
Income tax expense	701	176	—	877
<b>Net income</b>	<b>\$ 2,695</b>	<b>\$ 342</b>	<b>\$ —</b>	<b>\$ 3,037</b>
<b>Assets</b>	<b>\$ 935,361</b>	<b>\$ 29,004</b>	<b>\$ (30,721)</b>	<b>\$ 933,644</b>
<b>Nine Months ended September 30, 2002</b>				
Net interest income	\$ 29,241	\$ 765	\$ —	\$ 30,006
Provision for loan losses	2,219	—	—	2,219
<b>Net interest income after provision for loan losses</b>	<b>27,022</b>	<b>765</b>	<b>—</b>	<b>27,787</b>
Noninterest income	5,580	6,935	(131)	12,384
Noninterest expenses	20,287	6,209	(131)	26,365
<b>Income before income taxes</b>	<b>12,315</b>	<b>1,491</b>	<b>—</b>	<b>13,806</b>
Income tax expense	2,777	507	—	3,284
<b>Net income</b>	<b>\$ 9,538</b>	<b>\$ 984</b>	<b>\$ —</b>	<b>\$ 10,522</b>
<b>Assets</b>	<b>\$ 1,065,167</b>	<b>\$ 42,723</b>	<b>\$ (36,519)</b>	<b>\$ 1,071,371</b>
<b>Nine Months ended September 30, 2001</b>				
Net interest income	\$ 23,828	\$ 461	\$ —	\$ 24,289
Provision for loan losses	1,270	—	—	1,270
<b>Net interest income after provision for loan losses</b>	<b>22,558</b>	<b>461</b>	<b>—</b>	<b>23,019</b>
Noninterest income	5,596	6,294	(121)	11,769
Noninterest expenses	18,347	5,605	(121)	23,831
<b>Income before income taxes</b>	<b>9,807</b>	<b>1,150</b>	<b>—</b>	<b>10,957</b>
Income tax expense	1,972	391	—	2,363
<b>Net income</b>	<b>\$ 7,835</b>	<b>\$ 759</b>	<b>\$ —</b>	<b>\$ 8,594</b>
<b>Assets</b>	<b>\$ 935,361</b>	<b>\$ 29,004</b>	<b>\$ (30,721)</b>	<b>\$ 933,644</b>

**5. RECENT ACCOUNTING STATEMENTS**

In April 2002, the Financial Accounting Standards Board issued Statement 145, *Rescission of FASB No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. This Statement rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, and an amendment of that Statement, FASB Statement No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements*. This Statement also rescinds FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers*. This Statement amends FASB Statement No. 13, *Accounting for Leases*, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of this Statement related to the rescission of Statement 4 shall be applied in fiscal years beginning after May 15, 2002. The provisions of this Statement related to Statement 13 are effective for transactions occurring after May 15, 2002, with early application encouraged.

In June 2002, the Financial Accounting Standards Board issued Statement 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31 2002, with early application encouraged.

The Financial Accounting Standards Board issued Statement No. 147, *Acquisitions of Certain Financial Institutions, an Amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9* in October 2002. FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*, and FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method*, provided interpretive guidance on the application of the purchase method to acquisitions of financial institutions. Except for transactions between two or more mutual enterprises, this Statement removes acquisitions of financial institutions from the scope of both Statement 72 and Interpretation 9 and requires that those transactions be accounted for in accordance with FASB Statements No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*. Thus, the requirement in paragraph 5 of Statement 72 to recognize (and subsequently amortize) any excess of the fair value of liabilities assumed over the fair value of tangible and identifiable intangible assets acquired as an unidentifiable intangible asset no longer applies to acquisitions with the scope of this Statement. In addition, this Statement amends FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to include in its scope long-term customer-relationship intangible assets of financial institutions such as depositor- and borrower-relationship assets and credit cardholder intangible assets. Consequently, those intangible assets are subject to the same undiscounted cash flow recoverability test and impairment loss recognition and

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measurement provisions that Statement 144 requires for other long-lived assets that are held and used.

Paragraph 5 of FASB Statement 147, which relates to the application of the purchase method of accounting, is effective for acquisitions for which the date of acquisition is on or after October 1, 2002. The provisions in paragraph 6 related to accounting for the impairment or disposal of certain long-term customer-relationship intangible assets are effective on October 1, 2002. Transition provisions for previously recognized unidentifiable intangible assets in paragraphs 8-14 are effective on October 1, 2002, with earlier application permitted.

This Statement clarifies that a branch acquisition that meets the definition of a business should be accounted for as a business combination, otherwise the transaction should be accounted for as an acquisition of net assets that does not result in the recognition of goodwill.

The transition provisions state that if the transaction that gave rise to the unidentifiable intangible asset was a business combination, the carrying amount of that asset shall be reclassified to goodwill as of the later of the date of acquisition or the date Statement 142 was first applied (fiscal years beginning after December 15, 2001). Any previously issued interim statements that reflect amortization of the unidentifiable intangible asset subsequent to the Statement 142 application date shall be restated to remove that amortization expense. The carrying amounts of any recognized intangible assets that meet the recognition criteria of Statement 141 that have been included in the amount reported as an unidentifiable intangible asset and for which separate accounting records have been maintained shall be reclassified and accounted for as assets apart from the unidentifiable intangible asset and shall not be reclassified to goodwill.

The Corporation is currently in the process of evaluating the impact, if any, arising from the adoption of Statement 147.

## **6. FORWARD-LOOKING STATEMENTS**

Certain statements in this report may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualified words (and their derivatives) such as “expect,” “believe,” “estimate,” “plan,” “project,” or other statements concerning opinions or judgment of the Company and its management about future events. Although the Company believes that its expectations with respect to certain forward-looking statements are based upon reasonable assumptions within the bounds of its existing knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual future results and trends may differ materially from historical results or those anticipated depending on a variety of factors, including, but not limited to, the effects of and changes in: general economic conditions, the interest rate environment, legislative and regulatory requirements, competitive pressures, new products and delivery systems, inflation, changes in the stock and bond markets, technology, and consumer spending and

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savings habits. We do not update any forward-looking statements that may be made from time to time by or on behalf of the Company.

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### ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Union Bankshares Corporation (the "Company") is a multi-bank holding company organized under Virginia law which provides financial services through its wholly-owned bank subsidiaries, Union Bank & Trust Company, Northern Neck State Bank, Rappahannock National Bank, Bank of Williamsburg, as well as Union Investment Services, Inc., and Mortgage Capital Investors, Inc. The four subsidiary banks are full service retail commercial banks offering a wide range of banking and related financial services, including demand and time deposits, as well as commercial, industrial, residential construction, residential mortgage and consumer loans. Union Investment Services Inc., is a full service discount brokerage company, which offers a full range of investment services and sells mutual funds, stocks and bonds. Mortgage Capital Investors, Inc., a subsidiary of Union Bank & Trust Company, provides a wide array of mortgage products. Many of the services offered by the banks and the mortgage company can be accessed through Internet sites.

The Company's primary trade area stretches from Rappahannock County to Fredericksburg, south to Hanover County, east to Newport News and throughout the Northern Neck region of Virginia. The corporate headquarters is located in Bowling Green, Virginia. Through its banking subsidiaries, the Company operates 31 retail locations in its primary trade area. In addition to the primary banking trade area, Mortgage Capital Investors, Inc. expands the Company's mortgage origination business to other strong housing markets in Virginia, Maryland and South Carolina.

Management's discussion and analysis is presented to aid the reader in understanding and evaluating the financial condition and results of operations of the Company. The analysis focuses on the consolidated financial statements, the footnotes thereto, and the other financial data herein. Highlighted in the discussion are material changes from prior reporting periods and any identifiable trends affecting the Company. Amounts are rounded for presentation purposes, while the percentages presented may be computed based on unrounded amounts.

#### Critical Accounting Policies

##### *General*

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within the 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. The Company uses historical loss factors as one factor in determining the inherent loss that may be present in its loan portfolio. Actual losses could differ significantly from the historical factors that are used. The fair value of the investment portfolio is based on period end valuations but changes daily with the market. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of these transactions would be the same, the timing of events that would impact these transactions could change.

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### *Allowance for Loan Losses*

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) SFAS 5, *Accounting for Contingencies*, which requires that losses be accrued when they are likely to occur and the amount of loss can be reasonably estimated and (ii) SFAS 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.

The Company conducts an analysis of its loan portfolio on at least a quarterly basis to assess the adequacy of the allowance for loan losses. The review process considers specifically identified loans, as well as homogeneous pools of loans which are of similar size and risk. The Company specifically identifies and groups commercial and related loans utilizing an eight category internal risk rating system. The loan loss analysis model uses various information including historical losses, expected cash flows and fair market value of collateral, as well as current economic and business conditions, to develop estimated loss factors for these risk rated loans.

In addition, groups of loans which are similar in size and risk characteristics (e.g. residential mortgages, credit cards, installment loans, etc.) are classified as homogeneous loan pools. Historical losses and current economic and business conditions are used to develop estimated loss factors to be applied to these homogeneous pools in the loan loss analysis model. The total of estimated reserves for the risk rated loans and the homogeneous loan pools is then compared to the recorded allowance for loan losses.

The use of the various information above to develop estimated loss factors is inherently subjective and actual losses could be greater or less than the estimates. Management periodically reassesses the approach taken in these estimates in order to enhance the estimation process.

### Overview

Net income for the third quarter of 2002 was \$4.0 million, up 32.1% from \$3.0 million for the same period in 2001. This increase was the result of significant improvement in both business segments. The community banking segment earnings increased by \$861,000 or 31.9% over the prior year's third quarter due to improvement in the net interest margin and increases in earning assets. The mortgage segment's performance improved with net income of \$455,000 for the quarter ended September 30, 2002 compared to \$342,000 in the third quarter of 2001. Diluted earnings per share amounted to \$.52 in the third quarter of 2002, as compared to \$.40 in the same quarter of 2001. The Company's annualized return on average assets for the three months ended September 30, 2002 was 1.53% as compared to 1.30% a year ago. The Company's annualized return on average equity totaled 15.72% and 13.88% for the three months ended September 30, 2002 and 2001, respectively.

Net income from the Company's community bank segment increased from \$2.7 million in the third quarter of 2001 to over \$3.5 million in the third quarter of 2002. Much of this increase is attributable to improvements in net interest income and was driven largely by increases in earning assets and reductions in interest expense. Loan growth between year end 2001 and September 30, 2002 amounted to \$86.2 million while deposits grew \$68.0 million over the same period. This growth in earning assets helped to offset the impact of declining rates on interest income. In addition, interest expense declined significantly in a low interest rate environment as higher rate certificates of deposit repriced at lower rates over this nine month period. In addition,

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29.5%, or \$20.1 million of the growth was in noninterest bearing deposits while 33.7% or \$23.0 million of the increase was in other time deposits, primarily certificates of deposit, which also locked in at lower rates.

The mortgage segment reported net income of \$455,000, an increase of \$113,000 or 33.0% in the third quarter of 2002 driven by refinancings in a record low mortgage rate environment. While purchased loan closings increased moderately, refinanced loans moved from 25% of the total number of closed loans in the second quarter of 2002 to almost 36% in the third quarter which resulted in the increased earnings. Refinancings comprise approximately 33% of MCII's closings for the nine months ended September 30, 2002. MCII continues to focus its efforts toward the home purchase market, working with home buyers, builders, realtors and other referral sources for a stable loan production platform. The Company continues to monitor production volumes so adjustments in staffing and other areas can be made promptly. The volatility of mortgage rates, the slowly recovering economy and general uncertainty felt by consumers could adversely influence production over the next several quarters.

Total assets as of September 30, 2002 were \$1.070 billion, an increase of 8.9% from \$983.1 million at December 31, 2001. Loans totaled \$686.4 million at September 30, 2002, an increase of \$86.2 million or 14.4% from \$600.2 million at December 31, 2001. Approximately \$26.2 million of this growth has been generated by the Bank of Williamsburg (BOW) subsidiary due largely to the establishment of a new location in Newport News, Virginia. Many of these loans resulted from relationships the loan officers had established with these borrowers prior to joining BOW. The remaining growth in loans is attributable to increases in both the consumer and the commercial areas. The securities portfolio increased to \$265.6 million at the end of the third quarter of 2002, up from \$257.1 million at year end 2001. Loans held for sale at September 30, 2002 decreased \$3.7 million to \$39.7 million compared to the December 31, 2001 balance of \$43.5 million.

Total deposits at September 30, 2002 were \$852.1 million, up 8.7% from \$784.1 million at December 31, 2001. Management continues to focus on increasing and retaining lower cost deposit products (including noninterest-bearing demand deposits and savings accounts) and locking in current lower rates with longer (3-5 year) CD rates in an effort to maintain a lower cost of funds and a strong interest margin.

Net income for the nine months ended September 30, 2002 was \$10.5 million, up from \$8.6 million for the same period in 2001. This increase was the result of significant improvement in the community banking segment with increased earnings of \$1.7 million or 21.7% over the same period in 2001 due to improved net interest margin and increases in earning assets. The mortgage segment's performance improved with net income of \$984,000 for the nine months ended September 30, 2002 compared to \$759,000 at the same point last year. Diluted earnings per share amounted to \$1.38 for the nine months ended September 30, 2002, as compared to \$1.14 for the same period in 2001. The Company's annualized return on average assets for the nine months ended September 30, 2002 was 1.40% as compared to 1.27% a year ago while the annualized return on average equity totaled 14.78% and 13.73% for the same period, respectively.

### ***Net Interest Income***

Net interest income on a tax-equivalent basis for the third quarter of 2002 increased by 21.3% to \$11.0 million from \$9.1 million for the same period a year ago. The net interest income increase is largely attributable to a decline of \$1.9 million in interest-bearing liability



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costs compared to the prior year's third quarter. Most of this decrease was in the cost of interest-bearing deposits reflecting the impact of the rate cuts by the Federal Reserve in 2001 and 2002 and an increase in lower cost deposits in the deposit mix. Average interest-bearing deposits were up \$77.7 million for the quarter end September 30, 2002 from a year earlier, with 50.0% of this increase coming in lower cost NOW and money market accounts. Over that time, average interest earning assets grew by \$112.8 million or 13.0% and average interest-bearing liabilities increased by 10.7%.

The Company's yield on average earning assets was 6.94%, down 92 basis points from 7.86% a year ago, while its cost of average interest-bearing liabilities decreased 139 basis points from 4.37% in the third quarter 2001 to 2.98% in the comparable quarter of 2002. This reflects a faster decline in the cost of liabilities versus the income from earning assets. The favorable margin that we have experienced through 2002 decreased by 14 basis points from the second quarter of 2002 when it was 4.60% compared to 4.46% for the third quarter of 2002. As interest rates start to rise, we expect the margin to improve due to the asset-sensitive nature of our balance sheet. As investors sense a positive change in the economy and the stock market, some of those deposits may move back into the stock market and may cause the net interest margin to compress depending on the Company's liquidity levels.

Included in the average earning assets is \$25.4 million in loans held for sale. These loans are mortgage loans originated by the mortgage segment and held for the short period between closing with the customer and funding by the investor. The loans have their final rates locked and are presold to an investor. While the spread on these short term loans provides a positive contribution to interest income and net income, it negatively impacts the net interest margin as these loans are funded at more narrow, short-term spreads. These loans ultimately generate most of their earnings in the noninterest income category through gains on sales of loans.

In addition, the subsidiary banks have periodically engaged in wholesale leverage transactions to better leverage their capital position by borrowing funds to invest in securities at margins of 150 to 200 basis points. Although such transactions increase net income and return on equity, they negatively impact the net interest margin. As of September 30, 2002 such transactions accounted for \$10 million of the Company's total borrowings.

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**Union Bankshares Corporation**  
**AVERAGE BALANCES, INCOME AND EXPENSES, YIELDS AND RATES (TAXABLE EQUIVALENT BASIS)**

For the three months ended September 30,

	2002			2001			2000		
	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate
(Dollars in thousands)									
<b>Assets:</b>									
<b>Securities:</b>									
Taxable	\$ 169,358	\$ 2,396	5.61%	\$ 140,590	\$ 2,296	6.48%	\$ 125,953	\$ 2,315	7.31%
Tax-exempt(1)	92,031	1,747	7.53%	90,119	1,733	7.63%	97,649	1,623	6.61%
<b>Total securities</b>	<b>261,389</b>	<b>4,143</b>	<b>6.29%</b>	<b>230,709</b>	<b>4,029</b>	<b>6.93%</b>	<b>223,602</b>	<b>3,938</b>	<b>7.01%</b>
Loans, net	675,039	12,554	7.38%	589,118	12,722	8.57%	576,811	13,116	9.05%
Loans held for sale	25,390	357	5.58%	23,102	198	3.40%	13,747	70	2.03%
Federal funds sold	16,013	58	1.44%	22,079	196	3.52%	1,075	37	13.69%
Money market investments	120	1	3.31%	—	—	—	—	—	—
Interest-bearing deposits in other banks	1,280	5	1.55%	1,455	11	3.00%	1,042	16	6.11%
<b>Total earning assets</b>	<b>979,231</b>	<b>17,118</b>	<b>6.94%</b>	<b>866,463</b>	<b>17,156</b>	<b>7.86%</b>	<b>816,277</b>	<b>17,177</b>	<b>8.37%</b>
Allowance for loan losses	(8,614)			(7,884)			(7,811)		
<b>Total non-earning assets</b>	<b>71,621</b>			<b>66,920</b>			<b>65,521</b>		
<b>Total assets</b>	<b>\$ 1,042,238</b>			<b>\$ 925,499</b>			<b>\$ 873,987</b>		
<b>Liabilities &amp; Stockholders' Equity:</b>									
<b>Interest-bearing deposits:</b>									
Checking	\$ 122,684	259	0.84%	\$ 99,502	399	1.59%	\$ 99,000	545	2.19%
Money market savings	84,763	309	1.45%	69,103	496	2.85%	61,714	513	3.31%
Regular savings	79,604	265	1.32%	69,653	400	2.28%	56,178	339	2.40%
<b>Certificates of deposit:</b>									
\$100,000 and over	133,987	1,392	4.12%	127,855	1,807	5.61%	109,390	1,615	5.87%
Under \$100,000	287,718	2,823	3.89%	264,957	3,684	5.52%	262,762	3,868	5.86%
<b>Total interest-bearing deposits</b>	<b>708,756</b>	<b>5,048</b>	<b>2.83%</b>	<b>631,070</b>	<b>6,786</b>	<b>4.27%</b>	<b>589,044</b>	<b>6,880</b>	<b>4.65%</b>
Other borrowings	103,999	1,066	4.07%	102,976	1,297	5.00%	116,648	1,823	6.22%
<b>Total interest-bearing liabilities</b>	<b>812,755</b>	<b>6,114</b>	<b>2.98%</b>	<b>734,046</b>	<b>8,083</b>	<b>4.37%</b>	<b>705,692</b>	<b>8,703</b>	<b>4.91%</b>
<b>Noninterest-bearing liabilities:</b>									
Demand deposits	118,288			98,897			88,437		
Other liabilities	9,986			5,737			7,457		
<b>Total liabilities</b>	<b>941,029</b>			<b>838,680</b>			<b>801,586</b>		
Stockholders' equity	101,209			86,819			72,401		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,042,238</b>			<b>\$ 925,499</b>			<b>\$ 873,987</b>		
<b>Net interest income</b>		<b>\$ 11,004</b>			<b>\$ 9,073</b>			<b>\$ 8,474</b>	
Interest rate spread			3.95%			3.49%			3.47%
Interest expense as a percent of average earning assets			2.48%			3.70%			4.24%
Net interest margin			4.46%			4.15%			4.13%

(1) Income and yields are reported on a taxable equivalent basis.

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**Union Bankshares Corporation**  
**AVERAGE BALANCES, INCOME AND EXPENSES, YIELDS AND RATES (TAXABLE EQUIVALENT BASIS)**

For the nine months ended September 30,

	2002			2001			2000		
	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate
(Dollars in thousands)									
<b>Assets:</b>									
Securities:									
Taxable	\$ 167,172	\$ 7,270	5.81%	\$ 131,602	\$ 6,716	6.82%	\$ 123,179	\$ 6,805	7.38%
Tax-exempt(1)	92,074	5,281	7.67%	91,902	5,306	7.72%	98,116	5,376	7.32%
<b>Total securities</b>	<b>259,246</b>	<b>12,551</b>	<b>6.47%</b>	<b>223,504</b>	<b>12,022</b>	<b>7.19%</b>	<b>221,295</b>	<b>12,181</b>	<b>7.35%</b>
Loans, net	646,877	36,716	7.59%	586,731	38,810	8.84%	571,543	37,579	8.78%
Loans held for sale	22,492	1,070	6.36%	24,117	461	2.56%	9,633	304	4.22%
Federal funds sold	13,460	151	1.50%	11,551	322	3.73%	642	57	11.86%
Money market investments	851	12	1.89%	—	—	—	—	—	—
Interest-bearing deposits in other banks	1,014	12	1.58%	1,023	28	3.66%	995	48	6.44%
<b>Total earning assets</b>	<b>943,940</b>	<b>50,512</b>	<b>7.15%</b>	<b>846,926</b>	<b>51,643</b>	<b>8.15%</b>	<b>804,108</b>	<b>50,169</b>	<b>8.33%</b>
Allowance for loan losses	(8,091)			(7,793)			(7,333)		
<b>Total non-earning assets</b>	<b>71,009</b>			<b>68,596</b>			<b>60,459</b>		
<b>Total assets</b>	<b>\$ 1,006,858</b>			<b>\$ 907,729</b>			<b>\$ 857,234</b>		
<b>Liabilities &amp; Stockholders' Equity:</b>									
Interest-bearing deposits:									
Checking	\$ 118,940	827	0.93%	\$ 97,956	1,289	1.76%	\$ 99,715	1,601	2.14%
Money market savings	83,704	919	1.47%	65,176	1,445	2.96%	62,280	1,528	3.28%
Regular savings	76,701	767	1.34%	62,811	1,151	2.45%	57,309	1,027	2.39%
Certificates of deposit:									
\$100,000 and over	132,582	4,206	4.24%	127,336	5,603	5.88%	106,788	4,468	5.59%
Under \$100,000	279,925	8,578	4.10%	266,365	11,563	5.80%	257,170	10,806	5.61%
<b>Total interest-bearing deposits</b>	<b>691,852</b>	<b>15,297</b>	<b>2.96%</b>	<b>619,644</b>	<b>21,051</b>	<b>4.54%</b>	<b>583,262</b>	<b>19,430</b>	<b>4.45%</b>
Other borrowings	99,958	3,124	4.18%	105,655	4,229	5.35%	114,588	5,335	6.22%
<b>Total interest-bearing liabilities</b>	<b>791,810</b>	<b>18,421</b>	<b>3.11%</b>	<b>725,299</b>	<b>25,280</b>	<b>4.66%</b>	<b>697,850</b>	<b>24,765</b>	<b>4.74%</b>
Noninterest-bearing liabilities:									
Demand deposits	111,749			93,012			85,025		
Other liabilities	8,121			5,723			4,416		
<b>Total liabilities</b>	<b>911,680</b>			<b>824,034</b>			<b>787,291</b>		
Stockholders' equity	95,178			83,695			69,943		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,006,858</b>			<b>\$ 907,729</b>			<b>\$ 857,234</b>		
<b>Net interest income</b>		<b>\$ 32,091</b>			<b>\$ 26,363</b>			<b>\$ 25,404</b>	
Interest rate spread			4.04%			3.49%			3.59%
Interest expense as a percent of average earning assets			2.61%			3.99%			4.11%
Net interest margin			4.55%			4.16%			4.22%

(1) Income and yields are reported on a taxable equivalent basis.

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### ***Provision for Loan Losses***

The provision for loan losses totaled \$650,000 for the third quarter of 2002, up from \$445,000 for the third quarter of 2001. For the nine months ended September 30, 2002, the provision was \$2,219,000 versus \$1,270,000 for the same period in 2001. These provisions reflect the increase in the loan portfolio of 14.4% for the nine months ended September 30, 2002 compared to December 31, 2001 and management's assessment of the credit risk in the portfolio. (See *Asset Quality*)

### ***Noninterest Income***

Noninterest income for the three months ended September 30, 2002 totaled \$4.7 million, up \$657,000 from \$4.1 million for the same period a year ago. Over half of the increase came in gains on sales of loans in the mortgage banking segment which increased \$362,000 compared to the same quarter last year. Service charges on deposit accounts increased \$198,000 reflecting increases in overdraft and return check charges and DDA activity service charges. Other service charges and fees increased \$21,000, reflecting increases of \$38,000 in debit card income and \$4,000 in letter of credit fee income which more than offset a \$20,000 decline in brokerage commissions.

For the nine month period, noninterest income is up \$615,000 at \$12.4 million compared to \$11.8 million at September 30, 2001. This increase was largely the result of increases in the service charge income of \$186,000 and the gain on sale of loans of \$645,000 which were offset by a \$255,000 decline in the gains on securities transactions.

Management continues to seek additional sources of noninterest income, including increased emphasis on cross-selling services and better leveraging the financial services available throughout the organization.

### ***Noninterest Expense***

Noninterest expense in the third quarter of 2002 totaled \$9.1 million, an increase of \$965,000 over the same period in 2001. Personnel costs were up \$536,000 over last year's third quarter, with salaries and other benefits categories reflecting a rise in commission costs as a result of higher mortgage loan production normal increases, the addition of the Newport News branch and the Manassas LPO and higher group insurance expense. Occupancy expense was up \$36,000 largely as a result of rental costs for the offices in Newport News and Manassas and depreciation expense for the new branches in Tappahannock and Newport News. Furniture & equipment expense was down \$61,000 largely from a decline in depreciation expense and amortization of software. These decreases were the result of software and equipment, from the expansion in 1998 and the upgrades in 1999 to facilitate the back office consolidation, becoming fully depreciated.

Other operating expenses were up \$454,000 over last year's third quarter. The increases are primarily the result of: operating expenses up \$96,000 from software, postage, internet, telephone and courier and armored car costs; professional services down \$30,000; marketing up \$83,000 which includes the introduction of internet banking and preparation for centennial celebrations at Union Bank and Trust Company and Rappahannock National Bank; franchise tax up \$20,000 and other expense up \$167,000 due to other losses associated with a fraud issue that is in the process of being resolved and amortization of core deposit premium from the purchase of the

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Tappahanock Branch in the fourth quarter of last year. Most of these increases were in the community bank. Management continues to monitor expenses closely to ensure the levels are in line with the Company's expectations.

Noninterest expense for the nine months is up \$2.5 million at \$26.4 at September 30, 2002 compared to \$23.8 million at September 30, 2001. Most of the increase is the result of a \$1.4 million increase in salaries and benefits, which is the result of new locations in Newport News, Manassas, and Thornburg as well as normal salary increases. In addition, higher mortgage loan volume raised the commission expense in this category. Other operating expense is up \$1.1 million as a result of higher marketing expenses, higher operating expenses for new locations and new products, and higher other losses as a result of robberies in the first quarter.

## Asset Quality

The allowance for loan losses is an estimate of an amount adequate to absorb potential losses inherent in the loan portfolio. General economic trends, as well as conditions affecting individual borrowers, affect the level of credit losses. Management's determination of the adequacy of the allowance is based on a quarterly evaluation that considers the composition of the loan portfolio, the value and adequacy of the collateral, current economic conditions, historical loan loss experience, and other risk factors. The allowance is also subject to regulatory examinations and determination as to adequacy, which may take into account such factors as the methodology used to calculate the allowance and comparison to peer groups. The level of the allowance to net loans outstanding will vary depending on the overall results of the quarterly evaluation. The evaluation is reviewed by the Credit Risk Committee (comprised of members of senior management) and reviewed with the Audit Committee of the Board of Directors. Although general market and economic conditions are somewhat uncertain, management believes the allowance is adequate at this time and will continue to make adjustments as the changing economy and the loan portfolio's performance warrant.

The allowance for loan losses totaled \$8.9 million at September 30, 2002 or 1.30% of total loans, as compared to 1.22% at December 31, 2001 and 1.25% at September 30, 2001.

	September 30, 2001	December 31, 2001	September 30, 2002
	(dollars in thousands)		
Nonaccrual loans	\$ 530	\$ 915	\$ 1,307
Foreclosed properties	781	768	888
Nonperforming assets	\$ 1,311	\$ 1,683	\$ 2,195
Allowance for loan losses	\$ 8,946	\$ 7,336	\$ 7,463
Allowance as% of total loans	1.30%	1.22%	1.25%
Allowance as% of nonperforming assets	682%	436%	340%
Nonperforming assets to loans and foreclosed properties	.19%	.28%	.37%

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### Capital Resources

Capital resources represent funds, earned or obtained, over which financial institutions can exercise greater or longer control in comparison with deposits and borrowed funds. The adequacy of the Company's capital is reviewed by management on an ongoing basis with reference to the size, composition, and quality of the Company's resources and consistency with regulatory requirements and industry standards. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and absorb potential losses.

Since December 31, 2001 stockholders' equity has increased by \$15.3 million to \$104.3 million at September 30, 2002, principally as a result of net income of \$10.5 million for the first nine months of 2002. This increase was partially offset by dividends paid to stockholders of \$1.9 million. In addition, stockholders' equity increased by \$6.1 million due to net increases in the value of the Company's securities portfolio and by \$648,000 from stock issued under the dividend reinvestment and incentive stock plans and in connection with a prior acquisition.

The Federal Reserve, along with the Comptroller of the Currency and the Federal Deposit Insurance Corporation, has adopted capital guidelines to supplement the existing definitions of capital for regulatory purposes and to establish minimum capital standards. Specifically, the guidelines categorize assets and off-balance sheet items into four risk-weighted categories. The minimum ratio of qualified capital to qualifying total assets is 8.0%, of which 4.0% must be Tier 1 capital, consisting of common equity and retained earnings, less certain goodwill items.

At September 30, 2002, the Company's ratio of total capital to risk-weighted assets was 12.29% and its ratio of Tier 1 capital to risk-weighted assets was 11.18%. Both ratios exceed the minimum capital requirements. The following summarizes the Company's regulatory capital and related ratios at September 30, 2002 (dollars in thousands):

Tier 1 capital	\$	89,714
Tier 2 capital		8,946
Total risk-based capital		98,660
Total risk-weighted assets		802,683

#### **Capital Ratios:**

Tier 1 risk-based capital ratio	11.18%
Total risk-based capital ratio	12.29%
Leverage ratio (Tier 1 capital to average adjusted total assets)	8.66
Equity to assets ratio	9.75

The Company's book value per share at September 30, 2002 was \$13.80. Dividends to stockholders are typically paid semi-annually in May and November.

### Liquidity

Liquidity represents an institution's ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, money market investments, Federal funds sold, securities available for sale and loans maturing within one year. The Company's ability to obtain deposits and purchase funds at favorable rates determines its liability liquidity. Additional sources of liquidity available to the Company

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include its capacity to borrow additional funds when necessary through Federal funds lines with several regional banks and a line of credit with the Federal Home Loan Bank. Management considers the Company's overall liquidity to be sufficient to satisfy its depositors' requirements and to meet its customers' credit needs.

At September 30, 2002 cash, interest-bearing deposits in other banks, money market investments, Federal funds sold, securities available for sale, loans available for sale and loans that mature or reprice in one year were 48.2% of total earning assets. At September 30, 2002 approximately \$350.4 million or 51.1% of total loans are scheduled to mature or reprice within the next year. In addition to deposits, the Company utilizes Federal funds purchased, FHLB advances, securities sold under agreements to repurchase and customer repurchase agreements, to fund the growth in its loan portfolio, securities purchases, and periodically, wholesale leverage transactions.

### ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. The Company's market risk is composed primarily of interest rate risk. The Company's Asset and Liability Management Committee (ALCO) is responsible for reviewing the interest rate sensitivity position and establishing policies to monitor and limit exposure to this risk. The Board of Directors reviews the guidelines established by ALCO.

Interest rate risk is monitored through the use of three complimentary modeling tools: static gap analysis, earnings simulation modeling and economic value simulation (net present value estimation). Each of these models measure changes in a variety of interest rate scenarios. While each of the interest rate risk measures has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company, the distribution of risk along the yield curve, the level of risk through time, and the amount of exposure to changes in certain interest rate relationships. Due to the numerous assumptions used in the computations of interest rate sensitivity, and the fact that the models do not assume any actions ALCO could take in response to changes in interest rates, the model forecasts may not be indicative of actual results.

Static gap, which measures aggregate repricing values, is less utilized since it does not effectively measure the earnings impact on the Company and is not addressed here. Earnings simulation and economic value models, which more effectively measure the earnings impact are utilized by management on a regular basis and are explained below.

#### *Earnings Simulation Analysis*

Management uses simulation analysis to measure the sensitivity of net income to changes in interest rates. The model calculates an earnings estimate based on current and projected balances and rates. This method is subject to the accuracy of the assumptions that underlie the process, but it provides a better analysis of the sensitivity of earnings to changes in interest rates than other analysis such as the static gap analysis.

Assumptions used in the model, including loan and deposit growth rates, are derived from seasonal trends and management's outlook, as are the assumptions used to project yields and rates for new loans and deposits. All maturities, calls and prepayments in the securities portfolio are assumed to be reinvested in like instruments. Mortgage loans and mortgage backed securities prepayment assumptions are based on industry estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Different interest rate scenarios and yield curves are used to measure the sensitivity of earnings to changing interest rates. Interest rates on different asset and liability accounts move differently when the prime rate changes and are accounted for in the different rate scenarios.



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The following table represents the interest rate sensitivity on (fully tax equivalent basis) net income for the Company using different rate scenarios as of September 30, 2002:

Change in Prime Rate	% Change in Net Income
+200 basis points	+18.32 %
+100 basis points	+ 9.64 %
Most likely	- 0 -
-100 basis points	- 8.88
-200 basis points	-16.89 %

### *Economic Value Simulation*

Economic value simulation is used to calculate the estimated fair value of assets and liabilities over different interest rate environments. Economic values are calculated based on discounted cash flow analysis. The economic value of equity is the economic value of all assets minus the economic value of all liabilities. The change in economic value of equity over different rate environments is an indication of the longer term repricing risk in the balance sheet. The same assumptions are used in the economic value simulation as in the earnings simulation.

The following chart reflects the change in net market value over different rate environments as of September 30, 2002:

Change in Prime Rate	Change in Economic Value of Equity (dollars in thousands)
+200 basis points	\$ 4,683
+100 basis points	3,677
Most likely	- 0 -
-100 basis points	- 6,280
-200 basis points	- 13,541

**ITEM 4 – 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 within 90 days of the filing date of 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 significantly 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.

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**PART II - OTHER INFORMATION**

**Item 1 – Legal Proceedings**

**Item 2 – Changes in Securities and Use of Proceeds**

**Item 3 – Defaults Upon Senior Securities**

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

**Item 5 – Other Information**

**Item 6 - Exhibits and Reports on Form 8-K**

- (a) See attached list of exhibits
- (b) Form 8-K - None

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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.

**UNION BANKSHARES CORPORATION**

(Registrant)

November 14, 2002  
(Date)

/s/ G. WILLIAM BEALE

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**G. William Beale,  
President, Chief Executive Officer and Director**

November 14, 2002  
(Date)

/s/ D. ANTHONY PEAY

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**D. Anthony Peay,  
Senior Vice President and Chief Financial Officer**

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**Index to Exhibits**  
**Form 10-Q /September 30, 2002**

Exhibit No.	Description	
2	Plan of acquisition, reorganization, arrangement, liquidation or succession	<b>Not Applicable</b>
4	Instruments defining the rights of security holders, including indentures	<b>Not Applicable</b>
10	Material contracts	<b>Not Applicable</b>
11	Statement re: computation of per share earnings	<b>Not Applicable</b>
15	Letter re: unaudited interim financial information	<b>Not Applicable</b>
18	Letter re: change in accounting principles	<b>Not Applicable</b>
19	Previously unfiled documents	<b>Not Applicable</b>
20	Report furnished to security holders	<b>Not Applicable</b>
22	Published report re: matters submitted to vote of security holders	<b>None</b>
23	Consents of experts and counsel	<b>Not Applicable</b>
24	Power of Attorney	<b>Not Applicable</b>
99	Certifications pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	<b>99.1</b>

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**CERTIFICATIONS**

I, G. William Beale, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Union Bankshares Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ G. WILLIAM BEALE

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**G. William Beale**  
**President and Chief Executive Officer**

UNION BANKSHARES CORPORATION AND SUBSIDIARIES

**CERTIFICATIONS**

I, D. Anthony Peay, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Union Bankshares Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ D. ANTHONY PEAY

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**D. Anthony Peay**  
**Senior Vice President and Chief Financial Officer**

**Exhibit 99.1**

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Union Bankshares Corporation (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

/s/ G. WILLIAM BEALE

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**G. William Beale,  
Chief Executive Officer**

/s/ D. ANTHONY PEAY

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**D. Anthony Peay,  
Chief Financial Officer**

November 14, 2002