STEL 10-Q 9/30/2008

Section 1: 10-Q (FORM 10-Q)

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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, 2008

OR

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

For the transition period from ______ to ______

Commission File Number: 000-22283

StellarOne Corporation
(Exact name of registrant as specified in its charter)

Virginia **(State or other jurisdiction of incorporation or organization)**	**54-1829288** **(I.R.S. Employer Identification No.)**
590 Peter Jefferson Parkway Charlottesville, Virginia **(Address of principal executive offices)**	**22911** **(Zip Code)**

(Registrant's telephone number 434-964-2211, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report(s), 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, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☒

Non-accelerated filer ☐ Smaller reporting company ☐

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: 22,599,223 shares of Common Stock, par value $1.00 per share, were outstanding as of November 5, 2008.

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STELLARONE CORPORATION

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PART I – FINANCIAL INFORMATION
ITEM 1. Financial statements

STELLARONE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands)

	SEPTEMBER 30, 2008 (unaudited)	DECEMBER 31, 2007
ASSETS		
Cash and due from banks	$ 60,513	$ 41,091
Federal funds sold	20,043	321
Interest-bearing deposits in banks	291	381
Cash and cash equivalents	80,847	41,793
Investment securities (fair value: 2008, $374,082; 2007, $230,240)	374,080	230,226
Mortgage loans held for sale	8,975	5,354
Loans receivable, net of allowance for loan losses, 2008, $32,101; 2007, $15,082	2,254,904	1,212,595
Premises and equipment, net	87,510	37,307
Accrued interest receivable	11,738	7,747
Deferred income tax asset	4,057	3,906
Core deposit intangibles, net	10,704	3,225
Goodwill	74,488	13,896
Bank owned life insurance	28,572	10,725
Foreclosed assets	4,189	3,031
Other assets	45,794	25,013
Total assets	$ 2,985,858	$ 1,594,818
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 333,826	$ 204,774
Interest-bearing	2,016,090	937,773
Total deposits	2,349,916	1,142,547
Federal funds purchased and securities sold under agreements to repurchase	708	20,000
Federal Home Loan Bank advances	220,717	169,000
Subordinated debt	32,991	20,619
Commercial paper	—	68,745
Other borrowings	—	892
Accrued interest payable	5,491	3,555
Other liabilities	11,068	6,692
Total liabilities	2,620,891	1,432,050
STOCKHOLDERS' EQUITY		
Preferred stock; no par value; 5,000,000 shares authorized; no shares issued and outstanding;	—	—
Common stock, $1 par value; 25,000,000 shares authorized; 2008: 22,599,223 shares issued and outstanding; 2007: 10,795,943 shares issued and outstanding	22,599	10,796
Additional paid-in capital	225,411	34,488
Retained earnings	118,273	117,009
Accumulated other comprehensive (loss) income, net	(1,316)	475
Total stockholders' equity	364,967	162,768
Total liabilities and stockholders' equity	$ 2,985,858	$ 1,594,818

The accompanying notes are an integral part of these consolidated financial statements.

STELLARONE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	THREE MONTHS ENDED SEPTEMBER 30,	
	2008 (unaudited)	2007 (unaudited)
Interest Income		
Loans, including fees	$ 37,619	$ 21,891
Federal funds sold and deposits in other banks	291	13
Investment securities:		
Taxable	2,829	1,738
Tax exempt	888	922
Dividends	311	150
Total interest income	41,938	24,714
Interest Expense		
Deposits	12,839	7,634
Federal funds purchased and securities sold under agreements to repurchase	4	190
Federal Home Loan Bank advances	1,795	1,206
Subordinated debt	481	426
Commercial paper	—	844
Other borrowings	1	12
Total interest expense	15,120	10,312
Net interest income	26,818	14,402
Provision for loan losses	6,000	200
Net interest income after provision for loan losses	20,818	14,202
Noninterest Income		
Retail banking fees	4,083	2,008
Commissions and fees from fiduciary activities	984	855
Brokerage fee income	316	185
Mortgage banking-related fees	607	602
Losses on sales / impairments of foreclosed assets	(1,669)	—
Losses on sales of premises and equipment	—	(19)
(Losses) gains on sales / (impairments) of securities	(333)	67
Income from bank owned life insurance	359	135
Other income	737	424
Total noninterest income	5,084	4,257
Noninterest Expense		
Compensation and employee benefits	11,251	6,635
Net occupancy	2,040	907
Supplies and equipment	2,202	1,017
Amortization-intangible assets	438	161
Marketing	565	480
State franchise taxes	556	298
FDIC insurance	661	36
Data processing	726	451
Professional fees	622	195
Telecommunications	513	273
Other expenses	3,585	1,935
Total noninterest expense	23,159	12,388
Income before income taxes	2,743	6,071
Income tax expense	714	1,748
Net income	$ 2,029	$ 4,323
Earnings per share, basic	$ 0.09	$ 0.40
Earnings per share, diluted	$ 0.09	$ 0.40

The accompanying notes are an integral part of these consolidated financial statements.

STELLARONE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	NINE MONTHS ENDED SEPTEMBER 30, 2008 (unaudited)	NINE MONTHS ENDED SEPTEMBER 30, 2007 (unaudited)
Interest Income		
Loans, including fees	$ 104,088	$ 66,154
Federal funds sold and deposits in other banks	853	84
Investment securities:		
Taxable	8,039	5,287
Tax exempt	2,720	2,792
Dividends	918	410
Total interest income	116,618	74,727
Interest Expense		
Deposits	35,501	24,008
Federal funds purchased and securities sold under agreements to repurchase	64	415
Federal Home Loan Bank advances	5,334	2,951
Subordinated debt	1,411	1,264
Commercial paper	635	2,388
Other borrowings	7	28
Total interest expense	42,952	31,054
Net interest income	73,666	43,673
Provision for loan losses	9,787	365
Net interest income after provision for loan losses	63,879	43,308
Noninterest Income		
Retail banking fees	10,546	5,671
Commissions and fees from fiduciary activities	2,952	2,541
Brokerage fee income	954	735
Mortgage banking-related fees	2,836	1,846
Losses on sales / impairments of foreclosed assets	(2,428)	—
Losses on sales of premises and equipment	(64)	(23)
(Losses) gains on sales / (impairments) of securities	(95)	36
Income from bank owned life insurance	856	366
Other income	2,338	1,248
Total noninterest income	17,895	12,420
Noninterest Expense		
Compensation and employee benefits	34,182	20,492
Net occupancy	5,035	2,666
Supplies and equipment	5,913	3,303
Amortization-intangible assets	1,130	485
Marketing	1,813	1,122
State franchise taxes	1,535	840
FDIC insurance	776	115
Data processing	2,801	1,349
Professional fees	1,836	722
Telecommunications	1,260	747
Other expenses	10,525	5,688
Total noninterest expense	66,806	37,529
Income before income taxes	14,968	18,199
Income tax expense	4,712	5,317
Net income	$ 10,256	$ 12,882
Earnings per share, basic	$ 0.51	$ 1.19
Earnings per share, diluted	$ 0.51	$ 1.19

The accompanying notes are an integral part of these consolidated financial statements.

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STELLARONE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007
(In thousands, except per share data)
(unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Total
Balance, January 1, 2007	$10,784	$ 33,970	$106,924	$ (1,026)		$150,652
Comprehensive income:						
Net income	—	—	12,882	—	$ 12,882	12,882
Other comprehensive income, net of tax:						
Unrealized holding losses arising during the period (net of tax of $225)	—	—	—	—	$ 417	—
Reclassification adjustment (net of tax of $13)	—	—	—	—	$ 23	
Other comprehensive income				440	440	440
Total comprehensive income	—	—	—	—	$ 13,299	—
Cash dividends ($.48 per share)	—	—	(5,190)	—		(5,190)
Stock-based compensation expense (7,594 shares net of tax benefits)	8	321	—	—		329
Exercise of stock options (3,200 shares)	3	36	—	—		39
Balance, September 30, 2007	$10,795	$ 34,327	$114,616	$ (586)		$159,152
Balance, January 1, 2008	$10,796	$ 34,488	$117,009	$ 475		$162,768
Comprehensive income:						
Net income	—	—	10,256	—	$ 10,256	10,256
Other comprehensive loss, net of tax:						
Unrealized holding losses arising during the period (net of tax of $1,003)	—	—	—	—	(1,863)	—
Reclassification adjustment (net of tax of $33)	—	—	—	—	(62)	—
Change in funded status of pension plans	—	—	—	—	134	
Other comprehensive loss	—	—	—	(1,791)	(1,791)	(1,791)
Total comprehensive income	—	—	—	—	$ 8,393	—
Cash dividends ($.48 per share)	—	—	(8,992)	—		(8,992)
Common stock issued in merger (11,746,272 shares)	11,746	189,382	—	—		201,128
Stock-based compensation expense associated with merger (23,519 shares)	24	1,088	—	—		1,112
Stock-based compensation expense (7,018 shares net of tax benefits)	7	199	—	—		206
Exercise of stock options (26,471 shares)	26	254	—	—		280
Balance, September 30, 2008	$22,599	$ 225,411	$118,273	$ (1,316)		$364,967

The accompanying notes are an integral part of these consolidated financial statements.

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STELLARONE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2008 (unaudited)	2007 (unaudited)
Cash Flows from Operating Activities		
Net income	$ 10,256	$ 12,882
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,552	2,235
Amortization of intangible assets	1,130	485
Provision for loan losses	9,787	365
Deferred tax expense	791	177
Employee benefit plan expense	157	156
Stock-based compensation expense	1,318	329
Losses on sales / impairment of foreclosed assets	2,428	—
Losses on sale of premises and equipment	64	23
Losses (gains) on sales / impairment of securities available for sale	95	(36)
Mortgage banking-related fees	(2,836)	(1,846)
Proceeds from sale of mortgage loans	118,101	94,732
Origination of mortgage loans for sale	(104,975)	(91,895)
Amortization of premiums and accretion of discounts, net	(6,402)	(4)
Income on bank owned life insurance	(856)	(366)
Changes in assets and liabilities:		
Decrease (increase) in accrued interest receivable	2,619	(1)
Decrease (increase) in other assets	2,287	(3,016)
Decrease in accrued interest payable	(1,590)	(737)
Decrease in other liabilities	(22,402)	(770)
Net cash provided by operating activities	$ 13,524	$ 12,713
Cash Flows from Investing Activities		
Proceeds from maturities and principal payments of securities available for sale	$ 127,317	$ 63,634
Proceeds from sales and calls of securities available for sale	19,115	2,971
Purchase of securities available for sale	(93,146)	(44,289)
Net decrease in loans	19,006	6,071
Proceeds from sale of premises and equipment	1,273	40
Purchase of premises and equipment	(7,355)	(4,750)
Proceeds from sale of foreclosed assets	2,857	37
Cash acquired in merger	45,146	—
Net cash provided by investing activities	$ 114,213	$ 23,714

The accompanying notes are an integral part of these consolidated financial statements.

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STELLARONE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	NINE MONTHS ENDED SEPTEMBER 30, 2008 (unaudited)	NINE MONTHS ENDED SEPTEMBER 30, 2007 (unaudited)
Cash Flows from Financing Activities		
Net increase (decrease) in demand, money market and savings deposits	$ 63,837	$ (99,332)
Net decrease in certificates of deposit	(67,678)	(45,536)
Net decrease in federal funds purchased and securities sold under agreements to repurchase	(21,055)	35,500
Proceeds from Federal Home Loan Bank advances	119,600	127,000
Principal payments on Federal Home Loan Bank advances	(105,038)	(85,000)
Net (decrease) increase in commercial paper	(68,745)	17,450
Net (decrease) increase in other borrowings	(892)	3,652
Proceeds from exercise of stock options	280	39
Cash dividends paid	(8,992)	(5,190)
Net cash used by financing activities	$ (88,683)	$ (51,417)
Increase (decrease) in cash and cash equivalents	$ 39,054	$ (14,990)
Cash and Cash Equivalents		
Beginning	41,793	57,635
Ending	$ 80,847	$ 42,645
Supplemental Schedule of Noncash Activities		
Reclassification of fixed assets no longer in service to other assets	$ —	$ 1,119
Foreclosed assets acquired in settlement of loans	$ 5,102	$ —
Unrealized losses on securities available for sale	$ (2,866)	$ (1,456)
Common stock issued in merger	$ 201,128	$ —

The accompanying notes are an integral part of these consolidated financial statements.

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

StellarOne Corporation (the "Company" or "STEL") is a Virginia bank holding company headquartered in Charlottesville, Virginia. The Company's sole banking affiliate is StellarOne Bank headquartered in Christiansburg, Virginia. Additional affiliates of the Company include VFG Limited Liability Trust and FNB (VA) Statutory Trust II both of which are associated with the Company's subordinated debt issues and are not subject to consolidation. The Company collapsed all of its previous affiliates into StellarOne Bank on May 27, 2008. The previous affiliates included First National Bank (Christiansburg, Virginia), Second Bank & Trust (Fredericksburg, Virginia); Planters Bank & Trust Company of Virginia (Staunton, Virginia) and its subsidiary, Planters Insurance Agency, Inc.; and Virginia Commonwealth Trust Company (Culpeper, Virginia). The consolidated statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany accounts have been eliminated. In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the financial position as of September 30, 2008 and December 31, 2007, the results of operations for the three and nine months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007. The statements 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, 2007. The results of operations for the nine month period ended September 30, 2008 and 2007 are not necessarily indicative of the results to be expected for the full year.

2. Merger of Equals

On February 28, 2008, pursuant to the terms of the Agreement and Plan of Reorganization, dated as of July 26, 2007 (the "Merger Agreement"), by and between Virginia Financial Group, Inc. and FNB Corporation, each share of common stock of FNB Corporation outstanding was converted into 1.5850 shares of the Company's common stock. Virginia Financial Group, Inc., as the surviving corporation, changed its name to StellarOne Corporation. The Company issued 11,746,272 shares or approximately $201 million of its common stock to FNB Corporation shareholders, based on 7,412,576 shares of FNB Corporation common stock outstanding as of February 27, 2007 and the closing price of the Company's common stock on the same date.

The merger transaction was accounted for under the purchase method of accounting and qualifies as a tax-free reorganization under Section 368(a) of the Internal Revenue Code. The merger resulted in $60.6 million of goodwill and $8.6 million of core deposit intangibles. The goodwill acquired is not tax deductible. The core deposit intangible was based on an independent valuation and will be amortized over the estimated life of the core deposits of 7.75 years, based on undiscounted cash flows. An unaudited summary of the preliminary estimated fair values of assets and liabilities of FNB Corporation as of February 27, 2008 is in the table below. The Company acquired the assets and assumed the liabilities as of that same date.

Cash and cash equivalents	$ 45,146
Loans receivable, net of allowance for loan losses	1,070,023
Investment securities	202,538
Premises and equipment	48,109
Core deposit intangible	8,608
Goodwill	60,593
Other assets	62,778
Deposits	(1,213,949)
Borrowings	(52,598)
Other liabilities	(30,120)
Net assets acquired	$ 201,128

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STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company's consolidated financial statements include the results of operations of FNB Corporation only from the date of acquisition. The following unaudited summary presents the consolidated results of operations of the Company on a pro forma basis for the nine months ended September 30, 2008 and 2007, as if FNB Corporation had been acquired on January 1, 2008 and 2007 respectively. The pro forma summary information does not necessarily reflect the results of operations that would have occurred if the acquisition had occurred at the beginning of the periods presented, or of results which may occur in the future.

A summary of pro forma combined financial statements is as follows (In thousands):

	Nine Months Ended September 30,	
	2008 (unaudited)	2007 (unaudited)
Net interest income	$ 87,383	$ 90,972
Provision for credit losses	9,678	2,666
Non-interest income	20,111	22,969
Non-interest expense	71,354	71,057
Income before income taxes	26,462	40,218
Income taxes	9,145	12,699
Net income	$ 17,317	$ 27,519

3. Loans Receivable

The Company's loan portfolio is composed of the following (In thousands):

	September 30, 2008 (unaudited)	December 31, 2007
Real estate loans:		
Construction and land development	$ 386,423	$ 211,918
Secured by 1-4 family residential	746,740	304,563
Commercial and multifamily	845,026	552,605
Commercial, financial and agricultural loans	227,503	125,410
Consumer loans	64,551	26,169
All other loans	15,706	5,924
Total loans	2,285,949	1,226,589
Deferred loan costs	1,056	1,088
Allowance for loan losses	(32,101)	(15,082)
Net loans	$ 2,254,904	$ 1,212,595

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STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Allowance for Loan Losses

Activity in the allowance for loan losses is as follows (In thousands):

	September 30, 2008 (unaudited)	December 31, 2007	September 30, 2007 (unaudited)
Balance, beginning	$ 15,082	$ 14,500	$ 14,500
Provisions for loan losses	9,787	2,040	365
Loans charged off	(5,212)	(1,762)	(433)
Recoveries	905	304	185
Net charge-offs	(4,307)	(1,458)	(248)
Allowance acquired via acquisition	11,539	—	—
Balance, ending	$ 32,101	$ 15,082	$ 14,617

Information about impaired loans as of the periods indicated is as follows (In thousands):

	September 30, 2008 (unaudited)	December 31, 2007
Impaired loans for which an allowance has been provided	$ 34,222	$ 7,744
Impaired loans for which an allowance has not been provided	22,055	3,087
Total impaired loans	$ 56,277	$ 10,831
Allowance provided for impaired loans, included in the allowance for loan losses	$ 9,270	$ 1,003

5. Commercial Paper and Other Borrowings

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction.

The Company has an unused line of credit agreement with a correspondent bank for general working capital needs. The $10 million line is unsecured, calls for variable interest payments and is payable on demand. There were no balances outstanding at September 30, 2008 and December 31, 2007, respectively.

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STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company had a commercial paper program whereby customers of the affiliate bank could invest in unrated commercial paper of STEL. Terms included a daily maturity and floating rate of interest. This program was discontinued during the second quarter and replaced with a depository product. There was no balance outstanding at September 30, 2008 and $68.7 million at December 31, 2007.

The average balance of short-term borrowings outstanding did not exceed 30 percent of stockholders' equity for the quarter or the nine month period ended September 30, 2008. The following table shows certain information regarding the Company's commercial paper for the quarter and nine month period ended September 30, 2007 (In thousands):

	Three Months Ended September 30, 2007 (unaudited)
End of period balance	$ 76,082
Weighted average rate at end of period	4.16%
Average balance	76,399
Weighted average rate	4.32%
Maximum balance of any month-end during the period	76,717

	Nine Months Ended September 30, 2007 (unaudited)
End of period balance	$ 76,082
Weighted average rate at end of period	4.16%
Average balance	69,983
Weighted average rate	4.50%
Maximum balance of any month-end during the period	76,717

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Earnings Per Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock for the three month periods ended September 30, 2008 and 2007. Potential dilutive stock had no effect on income available to common stockholders for the three month period.

	2008 (unaudited)		2007 (unaudited)	
	Weighted Average Shares	Per Share Amount	Weighted Average Shares	Per Share Amount
Basic earnings per share	22,599,189	$ .09	10,794,322	$ .40
Effect of dilutive securities:				
Restricted stock	20,516	—	4,834	—
Incentive stock options	6,278	—	—	—
Stock options	43,401	—	17,643	—
Diluted earnings per share	22,669,384	$ .09	10,816,799	$ .40

In 2008 and 2007, stock options representing 368,652 and 204,466 shares, respectively, were not included in the three month calculation of earnings per share as their effect would have been anti-dilutive.

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STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock for the nine month periods ended September 30, 2008 and 2007. Potential dilutive stock had no effect on income available to common stockholders for the nine month period.

	2008 (unaudited)		2007 (unaudited)	
	Weighted Average Shares	Per Share Amount	Weighted Average Shares	Per Share Amount
Basic earnings per share	20,095,261	$ .51	10,792,268	$ 1.19
Effect of dilutive securities:				
Restricted stock	16,213	—	3,572	—
Incentive stock options	7,816	—	—	—
Stock options	45,600	—	21,891	—
Diluted earnings per share	20,164,890	$ .51	10,817,731	$ 1.19

In 2008 and 2007, stock options representing 348,316 and 181,389 shares, respectively, were not included in the nine month calculation of earnings per share as their effect would have been anti-dilutive.

7. Stock-Based Compensation

FASB Statement No. 123 (R), "Share-Based Payment" requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

SFAS 123 (R) also requires that new awards to employees eligible for retirement prior to the award becoming fully vested be recognized as compensation cost over the period through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn the award. The Company had no such awards granted during the three or nine month periods.

Included within compensation and employee benefits expense for the nine month period ended September 30, 2008 and 2007 is $1.6 million and $349 thousand of stock-based compensation, respectively. An acceleration adjustment of $1.3 million related to the merger is included in expense for the nine month period ended September 30, 2008.

Stock option compensation expense is the estimated fair value of options granted amortized on a straight-line basis over the requisite service period for each separately vesting portion of the award. Fair value was estimated using the Black-Scholes option pricing model with the following assumptions: option term until exercise of approximately 4.50 to 5.5 years, volatility ranging from 24.3 to 25.8%, risk-free interest rate of 2.14% to 2.68% and an expected dividend yield of 3.7% to 4.3%.

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STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

A summary of the stock option plan at September 30, 2008 and 2007 and changes during the periods ended on those dates are as follows:

	2008		2007	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, January 1	239,671	$ 23.37	193,616	$ 21.17
Acquired via merger	311,606	14.02	—	—
Granted	123,061	18.27	56,968	30.07
Forfeited	(4,093)	21.16	(2,630)	25.32
Expired	(19,329)	14.60	(2,733)	18.45
Exercised	(27,311)	10.60	(3,200)	9.73
Outstanding, September 30,	623,605	$ 18.53	242,021	$ 23.28
Exercisable, September 30,	501,944		115,752	

The aggregate intrinsic value of the options outstanding as of September 30, 2008 was $2.6 million. The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the Company’s closing stock price on the last trading day of the quarter ended September 30, 2008 and the exercise price, multiplied by the number of options outstanding). The aggregate intrinsic value of the options currently exercisable as of September 30, 2008 was $2.3 million. The weighted average remaining contractual life is 4.7 years for exercisable options at September 30, 2008.

The following table summarizes nonvested restricted shares outstanding as of September 30, 2008 and the related activity during the period:

Nonvested Shares	Number of Shares	Weighted-Average Grant-Date Fair Value	(In thousands) Total Intrinsic Value
Nonvested at January 1, 2008	30,537	$ 24.37	$ 453
Acquired via merger	16,356	17.30	
Granted	34,006	16.28	
Vested & Exercised	(46,893)	24.02	$ (565)
Forfeited	—	—	
Nonvested at September 30, 2008	34,006	$ 16.28	$ 703

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The estimated unamortized compensation expense, net of estimated forfeitures, related to nonvested stock and stock options issued and outstanding as of September 30, 2008 that will be recognized in future periods is as follows (In thousands):

	Stock Options	Nonvested Restricted Stock	Total
For the remaining three months of 2008	$ 15	$ 100	$115
For year ended December 31, 2009	59	203	262
For year ended December 31, 2010	59	85	144
For year ended December 31, 2011	59	40	99
For year ended December 31, 2012	59	10	69
For year ended December 31, 2013	12	2	14
Total	$ 263	$ 440	$703

8. Employee Benefit Plan

The Company has a noncontributory pension plan which conforms to the Employee Retirement Income Security Act of 1974 (ERISA). The amount of benefits payable under the plan is determined by an employee's period of credited service. The amount of normal retirement benefit will be determined based on a Pension Equity Credit formula. The employee receives credits based on their age and years of service. The plan provides for early retirement for participants with five years of service and the attainment of age 55. The benefits are payable in single or joint/survivor annuities as well as a lump sum payment upon retirement or separation of service. The Company froze participation in this plan during 2003, and has approximately ninety-five participants remaining in the plan.

The components of net periodic benefit cost are as follows (In thousands):

	Nine Months Ended September 30,	
	2008	2007
Service cost	$ 140	$ 130
Interest cost	195	199
Expected return on plan assets	(254)	(219)
Amortization of prior service cost	24	24
Amortization of net obligation at transition	16	30
Net periodic benefit cost	$ 121	$ 164

The Company made one cash contribution totaling $27 thousand during the first nine months of 2008. The Company is utilizing a credit balance in its funding standard account for minimum contributions for the remainder of 2008. Please see Note 10 for discussion of a subsequent event related to the benefit plan.

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. Fair Value Option and Fair Value Measurements

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position "FSP" No. FAS 157-2, "Effective Date of FASB Statement No. 157." This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. FAS 157-2 has been deferred and therefore has not been adopted. The impact of adopting FAS 157 involved adding additional disclosure information and had no direct effect on the Company's financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard is effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

Fair Value Measurement

Statement 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Statement 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active." This FSP clarifies the application of FASB Statement No. 157, "Fair Value Measurements," in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This guidance was considered in determining the fair value of financial assets for STEL as of September 30, 2008.

Under SFAS No. 157, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. An adjustment to the pricing method used within either Level 1 or Level 2 inputs could generate a fair value measurement that effectively falls in a lower level in the hierarchy. These levels are:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value. The determination of where an asset or liability falls in the hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures each quarter and based on various factors, it is possible that an asset or liability may be classified differently from quarter to quarter. However, the Company expects changes in classifications between levels will be rare.

Securities: Investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relaying on the securities' relationship to other benchmark quoted securities. Level 1 securities include those traded on nationally recognized securities exchanges, U.S. Treasury securities, and money market funds. Level 2 securities include U.S. Agency securities, mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans held for sale: The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted price exists, the fair value of a loan is determined using quoted prices for a similar asset or assets, adjusted for the specific attributes of that loan. As such, the Company classifies loans subjected to nonrecurring fair value adjustments as Level 2.

Loans: The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan". The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Foreclosed assets: Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at net realizable value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Deferred compensation plans: Liabilities associated with deferred compensation plans are recorded at fair value on a recurring basis as Level 1 based on the fair value of the underlying securities. Fair value measurement is based upon quoted prices.

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis as of September 30, 2008 are summarized below (In thousands).

(unaudited)	Total	Level 1	Level 2	Level 3
Investment securities available-for-sale	$373,046	$2,876	$370,170	$ —
Total assets at fair value	$373,046	$2,876	$370,170	$ —
Other liabilities (1)	$ 2,755	$2,755	$ —	$ —
Total liabilities at fair value	$ 2,755	$2,755	$ —	$ —

(1) Includes liabilities associated with deferred compensation plans

Assets and Liabilities Measured on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of September 30, 2008 are included in the table below (In thousands).

(unaudited)	Total	Level 1	Level 2	Level 3
Loans - impaired loans	$56,277	$ —	$16,383	$39,894
Loans - loans held for investment	1,518	—	—	1,518
Loans held for sale - mortgage	8,975	—	8,975	—
Loans held for sale - other assets	2,524	—	—	2,524
Foreclosed assets	4,189	—	1,740	2,449
Total assets at fair value	$73,483	$ —	$27,098	$46,385
Total liabilities at fair value	$ —	$ —	$ —	$ —

10. Subsequent Event

On October 28, 2008 the Company's Board of Directors approved certain changes to existing retirement plans by freezing the benefits associated with the defined benefit pension plan, terminating employee stock ownership plan and enhancing the 401(k) defined contribution savings plan effective January 1, 2009. The Company will freeze the pension plan at the current benefit levels as of December 31, 2008, at which time the accrual of future benefits for eligible employees will cease. All retirement benefits earned in the pension plan as of December 31, 2008 will be preserved and all participants will be fully vested in their benefit.

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company will freeze the ESOP as of December 31, 2008, at which time the accrual of future benefits for eligible employees will cease. All eligible participants are fully vested in the plan, and benefit amounts to be received will be determined at the time of settlement to occur in 2009. Both pension and ESOP participants will begin to receive a 4% profit sharing contribution in addition to a 4% potential matching contribution to their 401(k) plan effective January 1, 2009.

The Company is still in process of reviewing the impact on its consolidated financial statements, and will record income of approximately $65 thousand in the fourth quarter of 2008 associated with the recognition of prior service cost, curtailment gains and unrecognized actuarial losses associated with the pension plan. The Company expects the plan changes for both the ESOP and pension plans will result in retirement-related and administrative expenses savings of $300 thousand for 2009 for both the ESOP and pension plans.

11. Recent Accounting Pronouncements

During 2007, the FASB issued EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsed Split-Dollar Life Insurance Arrangements "EITF 06-4", which concludes an employer should recognize a liability for postemployment benefits promised an employee based on the substantive arrangement between the employer and the employee. Effective January 1, 2008, the Company adopted EITF 06-4. Adoption of EITF 06-4 did not have a significant effect on the Company's consolidated financial statements.

During 2007, the FASB issued EITF 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance "EITF 06-10", which stipulates an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement if, based on the substantive arrangement with the employee, the employer has agreed to maintain life insurance during the employee's retirement or provide the employee with a death benefit. Under EITF 06-10, the employer should also recognize an asset based on the substance of the arrangement it has with the employee. Effective January 1, 2008, the Corporation adopted EITF 06-10. Adoption of EITF 06-10 did not have a significant effect on the Corporation's consolidated financial statements.

In June 2007, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." The Issue states that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase to additional paid-in capital. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. This Issue is effective for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. The Company has prospectively applied this Issue to applicable dividends declared on or after January 1, 2008. The adoption of EITF 06-11 did not have a material impact on the Company's consolidated financial statements.

In February 2008, FASB issued FSP 140-3 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" This FSP addresses the accounting for a transfer of a financial asset and a repurchasing financing. The FSP presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement under Statement 140. However, if certain criteria are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under Statement 140. This FSP is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those years. Management does not expect the adoption of this FSP to have a material impact on the Company's consolidated financial statements.

STELLARONE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In November 2007, the SEC issued Staff Accounting Bulletin ("SAB") No. 109. SAB No. 109 revises the view expressed in SAB No. 105 and states that the expected net future cash flows related to the associated servicing of a loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB No. 109 expands to all loan commitments, the view that internally-developed intangible assets, such as customer relationship intangible assets, should not be recorded as part of the fair value of a derivative loan commitment. SAB No. 109 is effective on a prospective basis for loan servicing activities related to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The adoption did not have a material impact on the Company’s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations", which revises SFAS No. 141 and changes multiple aspects of the accounting for business combinations. Under the guidance in SFAS No. 141R, the acquisition method must be used, which requires the acquirer to recognize most identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree at their full fair value on the acquisition date. Goodwill is to be recognized as the excess of the consideration transferred plus the fair value of the noncontrolling interest over the fair values of the identifiable net assets acquired. Subsequent changes in the fair value of contingent consideration classified as a liability are to be recognized in earnings, while contingent consideration classified as equity is not to be remeasured. Costs such as transaction costs are to be excluded from acquisition accounting, generally leading to recognizing expense and additionally, restructuring costs that do not meet certain criteria at acquisition date are to be subsequently recognized as post-acquisition costs. SFAS No. 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company anticipates that the standard will lead to more volatility in the results of operations during the periods surrounding an acquisition.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements – an amendment of ARB No. 51". SFAS No. 160 requires that a noncontrolling interest in a subsidiary (i.e. minority interest) be reported in the equity section of the balance sheet instead of being reported as a liability or in the mezzanine section between debt and equity. It also requires that the consolidated income statement include consolidated net income attributable to both the parent and noncontrolling interest of a consolidated subsidiary. A disclosure must be made on the face of the consolidated income statement of the net income attributable to the parent and to the noncontrolling interest. Also, regardless of whether the parent purchases additional ownership interest, sells a portion of its ownership interest in a subsidiary or the subsidiary participates in a transaction that changes the parent’s ownership interest, as long as the parent retains controlling interest, the transaction is considered an equity transaction. SFAS No. 160 is effective for annual periods beginning after December 15, 2008. Management does not expect the adoption of this Statement to have a material impact on the Company’s consolidated financial statements.

STELLARONE CORPORATION
ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides management’s analysis of the consolidated financial results of operations, financial condition, liquidity and capital resources of StellarOne Corporation ("StellarOne," "STEL" or the "Company") and its affiliates. This discussion and analysis should be read in conjunction with the financial statements and footnotes appearing elsewhere in this report.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, other periodic reports filed by STEL under the Securities Exchange Act of 1934 (the "Exchange Act") and any other written or oral statements made by or on behalf of STEL may include forward-looking statements that reflect STEL’s current views with respect to future events and financial performance. STEL intends that such forward-looking statements be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement in order to claim the protections provided by such safe harbor provisions. Forward-looking statements are not based on historical information, but are related to future operations, strategies, financial results, or other developments. Forward-looking statements are based on management’s expectations as well as certain assumptions and estimates made by, and information available to management at the time the statements are made and are, therefore, subject to various risks, uncertainties, and other factors that may cause actual results to differ materially from the views and projections expressed in such statements. These risks, uncertainties and other factors include, but are not limited to:

- Our ability to achieve the earnings expectations related to the businesses that were acquired, or that may be acquired in the future, including our consummated merger with FNB Corporation, which in turn depends on a variety of factors, including:
  - Our ability to achieve the anticipated cost savings and revenue enhancements with the respect to the acquired operations;
  - The continued growth of the markets that the acquired entities serve, consistent with recent historical experience;
  - The difficulties related to the integration of the businesses, including retention of key personnel and integration of information systems.
- Competitive pressure in the banking industry or in STEL’s markets may increase significantly,
- Changes in the interest rate environment may reduce margins,
- General economic conditions, either nationally or regionally, may be less favorable than expected, resulting in, among other things, credit quality deterioration,
- Changes may occur in banking legislation and regulation,
- Changes may occur in general business conditions, and
- Changes may occur in the securities markets.

When words such as "believes", "expects", "anticipates" or similar expressions are used, the Company is making forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s analysis only as of the date thereof. STEL undertakes no obligation to update or revise any forward-looking statements.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

StellarOne Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. Currently, STEL is one of the largest independent commercial bank holding companies headquartered in the Commonwealth of Virginia. The Company's sole banking affiliate is StellarOne Bank headquartered in Christiansburg, Virginia. Additional affiliates of the Company include VFG Limited Liability Trust and FNB (VA) Statutory Trust II both of which are associated with the Company's subordinated debt issues and are not subject to consolidation. The Company collapsed all of its previous affiliates into StellarOne Bank on May 27, 2008. The previous affiliates included First National Bank (Christiansburg, Virginia), Second Bank & Trust (Fredericksburg, Virginia); Planters Bank & Trust Company of Virginia (Staunton, Virginia) and its subsidiary, Planters Insurance Agency, Inc.; and Virginia Commonwealth Trust Company (Culpeper, Virginia. The organization has a network of sixty-three full-service financial centers, one loan production office, and over eighty ATMs stretching from the New River Valley, Roanoke Valley, Shenandoah Valley and Central and North Central Virginia.

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 our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one factor in determining inherent losses in our loan portfolio. Actual losses could differ significantly from the historical factors that we use.

Investment Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. The initial classification of securities is determined at the date of purchase.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated increase in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have been incurred, but not realized through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The Company's banking subsidiary conducts an analysis of the loan portfolio on a regular basis. This analysis is used in assessing the sufficiency of the allowance for loan losses and in the determination of the necessary provision for loan losses. The review process generally begins with lenders identifying problem loans to be reviewed on an individual basis for impairment. When a loan has been identified as impaired, a specific reserve may be established based on management's calculation of the loss embedded in the individual loan. In addition to impairment testing, the banking subsidiary has a ten point grading system for each non-homogeneous loan in the portfolio. Loans meeting the criteria for impairment are segregated for analysis from performing loans within the portfolio. Loans are then grouped by loan type and, in the case of commercial and construction loans, by risk rating. Each loan type is assigned an allowance factor based on historical loss experience, economic conditions, overall portfolio quality including delinquency rates and commercial real estate loan concentrations. The total of specific reserves required for impaired classified loans and the calculated reserves by loan category are then used to compute an estimated range of losses which is then compared to the recorded allowance for loan losses. This is the methodology used to determine the sufficiency of the allowance for loan losses and the amount of the provision for loan losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Larger groups of smaller balance homogeneous loans are collectively evaluated for impairment.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Goodwill

The Company has adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Accordingly, goodwill is no longer subject to amortization over its estimated useful life, but is subject to at least an annual assessment for impairment by applying a fair value based test. Additionally, under SFAS 142, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the asset can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful life. Branch acquisition transactions were outside the scope of SFAS 142 and, accordingly, intangible assets related to such transactions continued to amortize upon the adoption of SFAS 142. The cost of purchased deposit relationships and other intangible assets, based on independent valuation, are being amortized over their estimated lives not to exceed fifteen years. Amortization expense charged to operations was $1.1 million and $485 thousand for the nine months ended September 30, 2008 and 2007, respectively.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Deferred taxes are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Stock-Based Compensation

The Company has a stock-based employee compensation plan under which nonqualified stock options may be granted periodically to certain employees. The Company's stock options typically have an exercise price equal to at least the fair value of the stock on the date of grant, and vest based on continued service with the Company for a specified period, generally five years. The Company has adopted SFAS 123 (R), which requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

FASB Statement No. 123 (R), "Share-Based Payment" SFAS 123 (R) also requires that new awards to employees eligible for retirement prior to the award becoming fully vested be recognized as compensation cost over the period through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn the award.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Non-GAAP Financial Measures

This report refers to the efficiency ratio, which is computed by dividing non-interest expense by the sum of net interest income on a tax equivalent basis and non-interest income excluding gains or losses on securities, fixed assets and foreclosed assets. The same ratio is also calculated using operating earnings which excludes the after-tax effects of merger-related, integration, other-than-temporary impairments and nonrecurring litigation costs. This is a non-GAAP financial measure that we believe provides investors with important information regarding our operational efficiency. Such information is not in accordance with GAAP and should not be construed as such. Management believes such financial information is meaningful to the reader in understanding operating performance, but cautions that such information not be viewed as a substitute for GAAP. STEL, in referring to its net income, is referring to income under GAAP.

Results of Operations

STEL's earnings for the third quarter of 2008 were $2.0 million, or $.09 per diluted share, compared to $4.3 million or $.40 per diluted share, earned during the third quarter of 2007. These results reflect decreases of 53.5% and 77.5%, respectively, compared to the same quarter last year. Operating earnings which excludes the after-tax effects of merger-related, integration, other-than-temporary impairments and nonrecurring litigation costs for the third quarter of 2008 totaled $2.5 million, or $.11 per diluted share

For the first nine months of 2008, net income was $10.3 million compared to $12.9 million earned in the first nine months of 2007, a decrease of 20.2%. Diluted earnings per share for the first nine months of 2008 amounted to $.51 per share compared to $1.19 per share during the same period in 2007. Operating earnings for the first nine months of 2008, excluding the after-tax effects of merger-related, integration, other-than-temporary impairments and nonrecurring litigation costs, amounted to $12.5 million or $.62 per diluted share, compared to $12.9 million or $1.19 per diluted share for the same period in 2007.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Net Interest Income

Net interest income, on a tax-equivalent basis and excluding the effects of purchase accounting amortization, amounted to $25.2 million for the third quarter of 2008, essentially flat with the $25.3 million for the second quarter of 2008 and up when compared to $14.9 million for the same quarter in 2007. The core net interest margin, adjusted to exclude the effect of purchasing accounting amortization of $2.3 million, was 3.72% for the third quarter, up compared to 3.69% for the second quarter of 2008 and down 35 basis points compared to 4.07% for the same quarter in 2007. Including the effects of purchase accounting adjustments, the net interest margin was 4.06% for the quarter, compared to 4.37% for the second quarter of 2008 and 4.07% for the third quarter of 2007. For the nine months ended September 30, 2008, net interest income on a tax-equivalent basis was $75.4 million, an increase of $30.1 million or 66.5% from $45.3 million for the same period in 2007. The net interest margin for the nine month period ended September 30, 2008 was 4.11%, or unchanged when compared to the same period in 2007. The amortization of the purchase adjustments of $6.2 million affected the margin for the nine month period to a lesser degree than the quarter, but still helped to offset compression related to the decline in the targeted Federal funds rate and increases in nonperforming assets when compared to September 30, 2007.

Core margin is expected to experience modest compression during the fourth quarter as the rate of improvement in the cost of funds slows, loan yields are negatively impacted by the short-term rate reductions, loan and deposit growth slow due to market conditions, and the positive effects of amortizing the purchase adjustments lessen.

Asset yields decreased sequentially, with an average yield on assets of 6.45% for the third quarter of 2008, compared to 6.51% for the second quarter of 2008 and decreased forty-eight basis points when compared to 6.93% for the third quarter of 2007. Average cost of interest bearing liabilities increased to 2.75% for the third quarter of 2008, as compared to 2.53% for the second quarter of 2008 and 3.46% for the third quarter of 2007. This reduced funding costs during the second and third quarters were predominantly the result of reductions in interest expense of $2.7 million and $758 thousand recognized during the first nine months of 2008, which related to the amortization of premiums on CD's and FHLB advances, respectively, that were adjusted to market value as part of the merger. Additionally, funding costs were also reduced due to recent actions taken by the Fed during 2008 and an increased level of CD maturities repricing during the period.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	Three months ended September 30, (unaudited)					
	2008			2007		
Dollars in thousands	Average Balance	Interest Inc/Exp	Average Rates	Average Balance	Interest Inc/Exp	Average Rates
Assets						
Loans receivable, net	$2,279,282	$37,744	6.59%	$1,199,114	$21,930	7.26%
Investment securities						
Taxable	256,426	3,155	4.81%	165,128	1,888	4.47%
Tax exempt	86,908	1,366	6.15%	93,275	1,419	5.95%
Total investments	343,334	4,521	5.15%	258,403	3,307	5.01%
Interest bearing deposits	735	3	1.60%	545	4	2.87%
Federal funds sold	60,406	272	1.76%	667	9	5.28%
	404,475	4,796	4.64%	259,615	3,320	5.01%
Total earning assets	2,683,757	$42,540	6.30%	1,458,729	$25,250	6.87%
Total nonearning assets	309,093			107,662		
Total assets	$2,992,850			$1,566,391		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
Interest checking	$ 507,990	$ 439	0.34%	$ 172,637	$ 46	0.11%
Money market	232,802	1,096	1.87%	138,217	789	2.26%
Savings	202,329	1,935	3.79%	89,573	423	1.87%
Time deposits:						
Less than $100,000	754,557	6,014	3.16%	390,529	4,105	4.17%
$100,000 and more	351,678	3,355	3.78%	194,095	2,271	4.64%
Total interest-bearing deposits	2,049,356	12,839	2.49%	985,051	7,634	3.07%
Federal funds purchased and securities sold under agreements to repurchase	950	4	1.65%	13,899	190	5.35%
Federal Home Loan Bank advances	194,799	1,795	3.61%	91,440	1,206	5.16%
Subordinated debt	32,991	481	5.71%	20,619	426	8.08%
Commercial paper	—	—	N/A	76,399	844	4.32%
Other borrowings	6	1	65.22%	1,157	12	4.06%
	228,746	2,281	3.90%	203,514	2,678	5.15%
Total interest-bearing liabilities	2,278,102	15,120	2.63%	1,188,565	10,312	3.43%
Total noninterest-bearing liabilities	349,662			221,368		
Total liabilities	2,627,764			1,409,933		
Stockholders' equity	365,086			156,458		
Total liabilities and stockholders' equity	$2,992,850			$1,566,391		
Net interest income (tax equivalent)		$27,420			$14,938	
Average interest rate spread			3.67%			3.44%
Interest expense as percentage of average earning assets			2.24%			2.80%
Net interest margin			4.06%			4.07%

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STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	Nine months ended September 30, (unaudited)					
	2008			2007		
Dollars in thousands	Average Balance	Interest Inc/Exp	Average Rates	Average Balance	Interest Inc/Exp	Average Rates
Assets						
Loans receivable, net	$2,066,251	$104,371	6.75%	$1,209,413	$66,272	7.33%
Investment securities						
Taxable	243,015	8,999	4.87%	168,024	5,697	4.47%
Tax exempt	88,942	4,185	6.18%	93,996	4,295	6.03%
Total investments	331,957	13,184	5.22%	262,020	9,992	5.03%
Interest bearing deposits	1,651	16	1.27%	516	14	3.58%
Federal funds sold	50,113	795	2.07%	1,710	70	5.40%
	383,721	13,995	4.79%	264,246	10,076	5.03%
Total earning assets	2,449,972	118,366	6.45%	1,473,659	76,348	6.93%
Total nonearning assets	269,254			111,812		
Total assets	$2,719,226			$1,585,471		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
Interest checking	$ 436,958	$ 1,338	0.41%	$ 165,530	$ 179	0.14%
Money market	185,302	2,578	1.85%	155,812	2,943	2.53%
Savings	180,276	4,731	3.50%	93,835	1,050	1.50%
Time deposits:						
Less than $100,000	679,507	16,974	3.33%	401,010	12,738	4.25%
$100,000 and more	324,088	9,880	4.06%	203,978	7,098	4.65%
Total interest-bearing deposits	1,806,131	35,501	2.62%	1,020,165	24,008	3.15%
Federal funds purchased and securities sold under agreements to repurchase	4,757	64	1.77%	10,067	415	5.44%
Federal Home Loan Bank advances	205,461	5,334	3.41%	75,869	2,951	5.13%
Subordinated debt	30,146	1,411	6.15%	20,619	1,264	8.08%
Commercial paper	32,554	635	2.56%	69,983	2,388	4.50%
Other borrowings	459	7	2.00%	741	28	4.98%
	273,377	7,451	3.58%	177,279	7,046	5.24%
Total interest-bearing liabilities	2,079,508	42,952	2.75%	1,197,444	31,054	3.46%
Total noninterest-bearing liabilities	321,148			234,070		
Total liabilities	2,400,656			1,431,514		
Stockholders' equity	318,570			153,957		
Total liabilities and stockholders' equity	$2,719,226			$1,585,471		
Net interest income (tax equivalent)		$ 75,414			$45,294	
Average interest rate spread			3.70%			3.47%
Interest expense as percentage of average earning assets			2.34%			2.82%
Net interest margin			4.11%			4.11%

Noninterest Income

On an operating basis, which excludes gains and losses from sale of assets (foreclosed assets, fixed assets and securities) total non-interest income amounted to $7.1 million, a decrease of $615 thousand or 8.0% from $7.7 million for second quarter of 2008 and up $3.0 million compared to $4.2 million for the same quarter in the prior year. Retail banking fee income amounted to $4.1 million, an increase of $190 thousand or 4.9% compared to $3.9 million for the second quarter of 2008 and up $2.1 million compared to $2.0 million for the same quarter in 2007. Mortgage banking revenue amounted to $607 thousand, a decrease of $750 thousand or greater than 100%, as compared to $1.4 million for the second quarter of 2008 and up $6 thousand when compared to $601 thousand for the same quarter in 2007. Revenues from trust and brokerage for the third quarter of 2008 were $1.3 million, down $89 thousand or 6.4% compared to $1.4 million in the second quarter of 2008 on lower market valuations for assets under management. Revenues from trust and brokerage were up slightly from $1.0 million when compared to the same quarter in 2007. Fluctuations for the nine month periods mirror the analysis of the quarterly amounts above.

Additionally, StellarOne recorded a loss of $1.7 million included in losses on sale of foreclosed assets during the third quarter of 2008 in connection with the auction of certain assets that had been reclassified as held for sale in conjunction with the merger of Virginia Financial Group, Inc. and FNB Corporation. Proceeds from this auction amounted to $3.8 million, and approximately $1 million in property was taken back at auction and included in foreclosed assets and non-performing assets at quarter end. StellarOne recorded an other than temporary impairment charge of $274 thousand recorded in the third quarter associated with a small ownership in stock of Fannie Mae. This charge is included in losses on sale of securities.

Noninterest Expense

Non-interest expense for the third quarter of 2008 amounted to $23.2 million, a decrease of $1.5 million compared to $24.6 million for the second quarter of 2008 and an increase of $10.8 million compared to $12.4 million for the same quarter in the prior year. Normalizing the non-interest expense for non-recurring merger integration, other-than-temporary impairment and litigation costs of $670 thousand, and adjusting for the acceleration of deposit insurance premiums during the third quarter of $593 thousand associated with the exhausting of Federal Deposit Insurance Corporation (FDIC) insurance assessment credits, non-interest expenses decreased $2.7 million or 11% as compared to the second quarter of 2008. StellarOne's efficiency ratio was 66.63% for the third quarter of 2008, compared to 65.26% for the second quarter of 2008 and 64.71% for the same quarter in the prior year. Excluding the effects of nonrecurring items per above, the efficiency ratio was 65.15% for the third quarter compared to 67.29% for second quarter of 2008 and 66.06% for the same quarter in the prior year. For the nine month period ended September 30, 2008, the efficiency ratio was 69.60%, compared to 65.04% for the same period in 2007. Excluding the impact of expense items noted above, the efficiency ratio was 67.48% compared to 65.04% for the same nine month period in 2007. Noninterest expense for the nine month period was affected in the same manner as the quarter by the related increases in incremental costs and nonrecurring expenses. A settlement that is mutually satisfactory to both parties has been reached regarding the lawsuit generating the nonrecurring legal expenses and no further legal expenses regarding this matter are anticipated during the fourth quarter.

Income Taxes

Income tax expense for the third quarter of 2008 was $714 thousand resulting in an effective tax rate of 26.0% compared to $1.7 million, or 28.6%, for the third quarter of 2007. For the nine month period ended September 30, 2008, income tax expense amounted to $4.7 million, resulting in an effective tax rate of 31.5% compared to $5.3 million, or 29.1% for the same period in 2007. The decrease in the effective tax rate for the third quarter is a result of the permanent differences representing a much larger percentage of pretax income compared to prior periods due to the decreased income recognized during the quarter. The increase in the effective tax rate for the nine month period is a result of adjustments made to the treatment of non-deductible nature of merger and purchase accounting adjustments and earnings from tax-exempt securities decreasing as a percentage of total income which was somewhat offset by tax free income generated by the purchase of bank owned life insurance increasing as a percentage of total income.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Asset Quality

StellarOne's ratio of non-performing assets as a percentage of total assets increased to 1.62% as of September 30, 2008, compared to .47% at September 30, 2007 and .86% at June 30, 2008. This increase is a result of declining market conditions in general and the downgrade of one acquisition and development relationship of approximately $12 million to nonaccrual status during the third quarter of 2008. Annualized net charge-offs as a percentage of average loans receivable amounted to .44% for the third quarter of 2008, compared to .03% during the same period in the prior year and .22% for the second quarter of 2008. A provision for loan losses of $6.0 million was recorded for the third quarter of 2008, an increase of $3.2 million compared to the second quarter of 2008. The third quarter 2008 provision compares to net charge-offs of $2.5 million for the quarter, allowing for building of the allowance as a percentage of total loans to 1.40% as compared to 1.25% at June 30, 2008. The increased levels of provisioning reflect actions taken to address the continuing challenges in the residential housing market and deterioration of credit quality in a limited number of acquisition and development construction credits, with the largest concentration of credit issues emanating from a total exposure of approximately $50 million in the Smith Mountain Lake, Virginia resort area.

The following table provides information on asset quality statistics for the periods presented (In thousands):

	September 30, 2008	December 31, 2007	September 30, 2007
Non-accrual loans	$ 42,245	$ 3,937	$ 7,487
Troubled debt restructurings	372	—	—
Foreclosed assets	4,189	3,031	—
Loans past due 90 days accruing interest	1,554	—	—
Total non-performing assets	$ 48,360	$ 6,968	$ 7,487
Nonperforming assets to total assets	1.62%	0.44%	0.47%
Nonperforming assets to loans and foreclosed property	2.22%	0.57%	0.62%
Allowance for loan losses as a percentage of loans receivable	1.40%	1.23%	1.21%
Allowance for loan losses as a percentage of nonperforming assets	63.09%	216.45%	195.23%
Annualized net charge-offs as a percentage of average loans receivable	0.44%	0.12%	0.03%

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

Capital Resources

The management of capital in a regulated financial services industry must properly balance return on equity to stockholders while maintaining sufficient capital levels and related risk-based capital ratios to satisfy regulatory requirements. Additionally, capital management must also consider acquisition opportunities that may exist, and the resulting accounting treatment. The Company's capital management strategies have been developed to provide attractive rates of returns to stockholders, while maintaining its "well-capitalized" position at the banking subsidiary.

The primary source of additional capital to the Company is earnings retention, which represents net income less dividends declared. During the nine months ended September 30, 2008, the Company retained $1.3 million, or 12.3% of its net income. Stockholders' equity increased by $202.2 million, reflecting $201.1 million in equity acquired in the merger, the earnings retention, stock based compensation and option exercises totaling $1.6 million and a decrease of $1.8 million in accumulated comprehensive income net of tax.

The Company and its banking subsidiary are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and the subsidiary banks' financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and its banking subsidiary must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and reclassifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking subsidiary to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. As of September 30, 2008, the Company and the subsidiary bank met all minimum capital adequacy requirements to which they are subject and are categorized as "well capitalized." There are no conditions or events that management believes have changed the subsidiary bank's well capitalized position.

The following table includes information with respect to the Company's risk-based capital and equity levels as of September 30, 2008 (In thousands):

	Corporation	Bank
Tier 1 capital	$ 317,045	$ 287,174
Tier 2 capital	32,101	32,101
Total risk-based capital	349,146	319,275
Total risk-weighted assets	2,604,463	2,584,297
Average adjusted total assets	2,907,998	2,888,070
Capital ratios:		
Tier 1 risk-based capital ratio	12.17%	11.11%
Total risk-based capital ratio	13.41%	12.35%
Leverage ratio (Tier 1 capital to average adjusted total assets)	10.90%	9.94%
Equity to assets ratio	12.22%	12.47%
Tangible equity to assets ratio	9.65%	9.89%

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity

Liquidity is identified as the ability to generate or acquire sufficient amounts of cash when needed and at a reasonable cost to accommodate withdrawals, payments of debt, and increased loan demand. These events may occur daily or other short-term intervals in the normal operation of the business. Experience helps management predict time cycles in the amount of cash required. In assessing liquidity, management gives consideration to relevant factors including stability of deposits, quality of assets, economy of markets served, concentrations of business and industry, competition, and the Company's overall financial condition. The Company's primary sources of liquidity are cash, securities in our available for sale portfolio and a $10 million line of credit with a correspondent bank. In addition, the Bank has substantial lines of credit from its correspondent banks and access to the Federal Reserve discount window and Federal Home Loan Bank of Atlanta to support liquidity as conditions dictate.

The liquidity of the Company also represents an important aspect of liquidity management. The Company's cash outflows consist of overhead associated with corporate expenses, executive management, finance, marketing, human resources, loan and deposit operations, information technology, audit, compliance and loan review functions. It also includes outflows associated with dividends to shareholders. The main sources of funding for the Company are the management fees and dividends it receives from its banking subsidiary, a working line of credit with a correspondent bank, and availability of the subordinated debt security market as deemed necessary. The Company's capital base provides the resource and ability to support the assets of the Company and provide capital for future expansion.

In the judgment of management, the Company maintains the ability to generate sufficient amounts of cash to cover normal requirements and any additional funds as needs may arise.

Off Balance Sheet Items

There have been no material changes to the off balance sheet items disclosed in "Management's Discussion and Analysis" in STEL's annual report on Form 10-K for the fiscal year ended December 31, 2007.

Contractual Obligations

There have been no material changes outside the ordinary course of business to the contractual obligations disclosed in STEL's annual report on Form 10-K for the fiscal year ended December 31, 2007.

Effects of Inflation

The effect of changing prices on financial institutions is typically different from other industries as the Company's assets and liabilities are monetary in nature. Interest rates and thus the Company's asset liability management is impacted by changes in inflation, but there is not a direct correlation between the two measures. Management monitors the impact of inflation on the financial markets.

STELLARONE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Access to Filings

The Company provides access to its SEC filings through the corporate Website at http://www.StellarOne.com. After accessing the Website, the filings are available upon selecting Investor Relations, then the SEC Filings & Other Documents icon. Reports available include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are electronically filed with or furnished to the SEC.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no significant changes to the quantitative and qualitative market risk disclosures in the Company's Form 10-K for the year ended December 31, 2007.

ITEM 4 – CONTROLS AND PROCEDURES

We are required to include in our periodic reports information regarding our controls and procedures for complying with the disclosure requirements of the federal securities laws. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports 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.

We have established disclosure controls and procedures to ensure that material information related to the Company is made known to our principal executive officer and principal financial officer on a regular basis, in particular during the periods in which our quarterly and annual reports are being prepared. Our principal executive officer and principal financial officer evaluated the effectiveness of these disclosure controls and procedures as of the end of the period covered by this report and, based on their evaluation, concluded that our disclosure controls and procedures are operating effectively.

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 organization to disclose material information otherwise required to be set forth in our period 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. In the normal course we review and change our internal controls to reflect changes in our business including acquisition related improvements. We continue to evaluate additional processes and other components of internal control over financial reporting resulting from our recent business combination, including FNB Corporation's historical internal control over financial reporting and the integration of those internal controls into our own internal controls. This ongoing evaluation and integration may lead to our making additional changes in our internal control over financial reporting in future fiscal periods. Except as required in connection with these activities, there have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting.

STELLARONE CORPORATION

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

There are no material legal proceedings to which the Company or any of its subsidiary, directors, or officers is a party or by which they, or any of them, are threatened. Any legal proceeding presently pending or threatened against StellarOne Corporation and its subsidiaries are either not material in respect to the amount in controversy or fully covered by insurance.

ITEM 1a. RISK FACTORS.

The following is a certain risk factor that management believes to be specific to our business.

If our allowance for loan losses becomes inadequate, our results of operations may be adversely affected.

We maintain an allowance for loan losses that we believe is adequate to absorb estimated incurred losses inherent in our loan portfolio. Through a periodic review and consideration of the loan portfolio, management determines the amount of the allowance for loan losses by considering current general market conditions, credit quality of the loan portfolio and performance of our customers relative to their financial obligations with us. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond our control and these losses may cause our loan loss provision to vary widely from recent levels. Although we believe the allowance for loan losses is adequate to absorb probable incurred losses in our loan portfolio, it is an estimate subject to revision as losses are confirmed. Higher levels of loan losses in the future could have a material adverse impact on our financial performance. Federal and state regulators, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to increase our provision for loan losses or to recognize further loan charge offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses required by these regulatory agencies could have a negative effect on our financial condition and results of operations.

The above risk factor should not be viewed as an all inclusive list. See "item 1A. Risk Factors" of our 2007 10-K for additional risks that may affect our business.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

The Company has a stock repurchase program authorized that is not currently active, with 210,000 shares remaining available for repurchase.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

STELLARONE CORPORATION

PART II - OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

Not applicable.

ITEM 6. EXHIBITS:

(a) The following exhibits either are filed as part of this Report or are incorporated herein by reference:

Exhibit No. 2.1	Agreement and Plan of Reorganization, dated as of July 26, 2007, between Virginia Financial Group, Inc. and FNB Corporation, incorporated by reference to Exhibit 2.1 to Form 8-K filed July 30, 2007.
Exhibit No. 31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
Exhibit No. 31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
Exhibit No. 32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to 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.

STELLARONE CORPORATION

/s/ O. R. Barham, Jr.
O.R. Barham, Jr.
President and Chief Executive Officer
November 10, 2008

/s/ Jeffrey W. Farrar
Jeffrey W. Farrar, CPA
Executive Vice President and Chief Financial Officer
November 10, 2008

Section 2: EX-31.1 (SECTION 302 CEO CERTIFICATION)

Exhibit 31.1

CERTIFICATIONS

I, O. R. Barham, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of StellarOne Corporation;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 10, 2008

/s/ O. R. Barham, Jr.
O. R. Barham, Jr.

President and Chief Executive Officer

Section 3: EX-31.2 (SECTION 302 CFO CERTIFICATION)

Exhibit 31.2

I, Jeffrey W. Farrar, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of StellarOne Corporation;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2008

/s/ Jeffrey W. Farrar
Jeffrey W. Farrar
Executive Vice President and Chief Financial Officer

Section 4: EX-32 (SECTION 906 CEO AND CFO CERTIFICATION)

Exhibit 32

Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350)

The undersigned, as the Chief Executive Officer and Chief Financial Officer of StellarOne Corporation, respectively, certify that the Quarterly Report on Form 10-Q for the period ended September 30, 2008, which accompanies this certification fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of StellarOne Corporation at the dates and for the periods indicated. The foregoing certification is made pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), and no purchaser or seller of securities or any other person shall be entitled to rely upon the foregoing certification for any purpose. The undersigned expressly disclaim any obligation to update the foregoing certification except as required by law.

November 10, 2008 /s/ O. R. Barham, Jr.

President and Chief Executive Officer

November 10, 2008

/s/ Jeffrey W. Farrar

Executive Vice President and Chief Financial Officer