SCBT FINANCIAL CORP
Form 10-Q
August 10, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

o 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 001-12669

SCBT FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

South Carolina	**57-0799315**
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
520 Gervais Street **Columbia, South Carolina** (Address of principal executive offices)	**29201** (Zip Code)

(800) 277-2175

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o	Accelerated Filer x
Non-Accelerated Filer o	Smaller Reporting Company o

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

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

Class	Outstanding as of July 31, 2009
Common Stock, $2.50 par value	12,705,275

Table of Contents

SCBT Financial Corporation and Subsidiaries

June 30, 2009 Form 10-Q

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

SCBT Financial Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

(Dollars in thousands, except par value)

	June 30, 2009 (Unaudited)	December 31, 2008 (Note 1)	June 30, 2008 (Unaudited)
ASSETS			
Cash and cash equivalents:			
Cash and due from banks	**$ 80,822**	$ 47,024	$ 59,805
Interest-bearing deposits with banks	**220**	1,441	382
Federal funds sold and securities purchased under agreements to resell	**40,050**	1,000	44,351
Money market mutual funds	**36,000**		
Total cash and cash equivalents	**157,092**	49,465	104,538
Investment securities:			
Securities held to maturity (fair value of $21,748, $23,577 and $24,697, respectively)	**22,356**	24,228	25,017
Securities available for sale, at fair value	**153,643**	183,220	215,834
Other investments	**15,416**	14,779	15,540
Total investment securities	**191,415**	222,227	256,391
Loans held for sale	**53,853**	15,742	19,015
Loans	**2,236,162**	2,316,076	2,246,353
Less allowance for loan losses	**(32,431)**	(31,525)	(28,760)
Loans, net	**2,203,731**	2,284,551	2,217,593
Premises and equipment, net	**73,404**	66,392	57,698
Goodwill	**62,888**	62,888	62,888
Other assets	**64,926**	65,445	56,264
Total assets	**$ 2,807,309**	$ 2,766,710	$ 2,774,387
LIABILITIES AND SHAREHOLDERS EQUITY			
Deposits:			
Noninterest-bearing	**$ 322,270**	$ 303,689	$ 322,209
Interest-bearing	**1,858,096**	1,849,585	1,734,637
Total deposits	**2,180,366**	2,153,274	2,056,846
Federal funds purchased and securities sold under agreements to repurchase	**187,677**	172,393	322,682
Other borrowings	**144,430**	177,477	160,249
Other liabilities	**15,084**	18,638	13,147
Total liabilities	**2,527,557**	2,521,782	2,552,924
Shareholders equity:			
Preferred stock - $.01 par value; authorized 10,000,000 shares; no shares issued and outstanding			
Common stock - $2.50 par value; authorized 40,000,000 shares; 12,696,849, 11,250,603 and 10,203,497 shares issued and outstanding	**31,742**	28,127	25,509
Surplus	**195,181**	166,815	141,439

Retained earnings	**60,550**	59,171	59,147
Accumulated other comprehensive loss	**(7,721)**	(9,185)	(4,632)
Total shareholders equity	**279,752**	244,928	221,463
Total liabilities and shareholders equity	**$ 2,807,309**	$ 2,766,710	$ 2,774,387

The Accompanying Notes are an Integral Part of the Financial Statements.

1

Table of Contents

SCBT Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Income (unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Interest income:				
Loans, including fees	**$ 33,373**	$ 35,016	**$ 67,090**	$ 71,801
Investment securities:				
Taxable	**2,144**	2,696	**4,514**	5,596
Tax-exempt	**231**	493	**466**	921
Federal funds sold and securities purchased under agreements to resell	**84**	269	**166**	658
Money market funds	**21**		**65**	
Deposits with banks	**4**	15	**4**	47
Total interest income	**35,857**	38,489	**72,305**	79,023
Interest expense:				
Deposits	**8,188**	11,850	**17,929**	25,296
Federal funds purchased and securities sold under agreements to repurchase	**118**	1,350	**243**	3,677
Other borrowings	**1,532**	1,727	**3,116**	3,574
Total interest expense	**9,838**	14,927	**21,288**	32,547
Net interest income	**26,019**	23,562	**51,017**	46,476
Provision for loan losses	**4,521**	2,332	**9,564**	3,577
Net interest income after provision for loan losses	**21,498**	21,230	**41,453**	42,899
Noninterest income:				
Service charges on deposit accounts	**3,819**	4,032	**7,404**	7,837
Mortgage banking income	**2,134**	1,240	**3,395**	2,270
Bankcard services income	**1,290**	1,276	**2,472**	2,432
Trust and investment services income	**671**	681	**1,362**	1,377
Securities gains (losses), net		340		340
Total other-than-temporary impairment losses	**(2,482)**		**(2,482)**	
Portion of impairment losses recognized in other comprehensive loss	**1,938**		**1,938**	
Net impairment losses recognized in earnings	**(544)**		**(544)**	
Other	**391**	558	**803**	1,376
Total noninterest income	**7,761**	8,127	**14,892**	15,632
Noninterest expense:				
Salaries and employee benefits	**9,517**	10,863	**20,036**	22,084
Net occupancy expense	**1,559**	1,494	**3,142**	2,992
Furniture and equipment expense	**1,499**	1,573	**3,059**	3,090
Information services expense	**1,286**	1,141	**2,728**	2,320
FDIC assessment and other regulatory charges	**2,333**	437	**3,517**	897
OREO expense and loan related	**1,367**	184	**2,041**	533
Advertising and marketing	**571**	1,092	**1,221**	2,011
Professional fees	**557**	507	**991**	1,041
Amortization of intangibles	**132**	145	**263**	289
Other	**2,217**	2,259	**4,227**	4,567
Total noninterest expense	**21,038**	19,695	**41,225**	39,824
Earnings:				
Income before provision for income taxes	**8,221**	9,662	**15,120**	18,707

Provision for income taxes		**2,836**		3,513		**5,215**		6,595
Net income		**5,385**		6,149		**9,905**		12,112
Preferred stock dividends		**450**				**1,115**		
Accretion on preferred stock discount		**3,410**				**3,559**		
Net income available to common shareholders	**$**	**1,525**	$	6,149	**$**	**5,231**	$	12,112
Earnings per common share:								
Basic	**$**	**0.13**	$	0.61	**$**	**0.45**	$	1.20
Diluted	**$**	**0.13**	$	0.60	**$**	**0.45**	$	1.18
Dividends per common share	**$**	**0.17**	$	0.17	**$**	**0.34**	$	0.34
Weighted-average common shares outstanding:								
Basic		**11,827**		10,110		**11,516**		10,105
Diluted		**11,871**		10,253		**11,560**		10,239

The Accompanying Notes are an Integral Part of the Financial Statements.

2

Table of Contents

SCBT Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Changes in Shareholders Equity (unaudited)

Six Months Ended June 30, 2009 and 2008

(Dollars in thousands, except per share data)

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2007		$	10,160,432	$ 25,401	$ 140,652	$ 50,499	$ (1,487)	$ 215,065
Comprehensive income:								
Net income						12,112		12,112
Change in net unrealized loss on securities available for sale, net of tax							(3,145)	(3,145)
Total comprehensive income								8,967
Cash dividends declared at $.34 per share						(3,464)		(3,464)
Stock options exercised			4,419	11	87			98
Employee stock purchases			5,972	15	145			160
Restricted stock awards			34,964	88	(88)			
Common stock repurchased			(2,290)	(6)	(66)			(72)
Share-based compensation expense					709			709
Balance, June 30, 2008		$	10,203,497	$ 25,509	$ 141,439	$ 59,147	$ (4,632)	$ 221,463
Balance, December 31, 2008		$	11,250,603	$ 28,127	$ 166,815	$ 59,171	$ (9,185)	$ 244,928
Comprehensive income:								
Net income						9,906		9,906
Change in pension liability for plan curtailment, net of tax							1,283	1,283
Change in net unrealized gain on securities available for sale, net of tax							1,382	1,382
Noncredit portion of other-than-temporary impairment losses recognized in earnings, net of tax							(1,201)	(1,201)
Total comprehensive income								11,370
Cash dividends on Series T preferred stock at annual dividend rate of 5%		3,559				(4,674)		(1,115)
Cash dividends declared at $.34 per share						(3,853)		(3,853)
Issuance of Series T preferred stock, net of issuance costs	64,779	61,220			3,412			64,632
Repurchase of Series T preferred stock and warrants	(64,779)	(64,779)			(1,400)			(66,179)
Employee stock purchases			9,089	23	139			162
Restricted stock awards			86,560	217	(217)			
Common stock repurchased			(5,903)	(16)	(163)			(179)
Share-based compensation expense					753			753
Common stock issued in public offering			1,356,500	3,391	25,842			29,233
Balance, June 30, 2009		$	12,696,849	$ 31,742	$ 195,181	$ 60,550	$ (7,721)	$ 279,752

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

SCBT Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (unaudited)

(Dollars in thousands)

	Six Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net income	$ **9,906**	$ 12,112
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**3,388**	2,449
Provision for loan losses	**9,564**	3,577
Other-than-temporary impairment on securities	**544**	
Gain on sale of securities		(340)
Share-based compensation expense	**753**	709
Net accretion of investment securities	**(207)**	(143)
Net change in loans held for sale	**(38,112)**	(1,664)
Net change in miscellaneous assets and liabilities	**(1,997)**	(4,420)
Net cash provided by (used in) operating activities	**(16,161)**	12,280
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale		2,012
Proceeds from maturities and calls of investment securities held to maturity	**1,870**	3,140
Proceeds from maturities and calls of investment securities available for sale	**39,244**	52,945
Proceeds from sales of other investment securities	**451**	1,216
Purchases of investment securities held to maturity		(6,679)
Purchases of investment securities available for sale	**(9,709)**	(52,345)
Purchases of other investment securities	**(1,088)**	(2,944)
Net decrease (increase) in customer loans	**71,257**	(164,693)
Purchases of premises and equipment	**(4,588)**	(4,314)
Net cash provided by (used in) investing activities	**97,437**	(171,662)
Cash flows from financing activities:		
Net increase in deposits	**27,093**	128,957
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase and other short-term borrowings	**(5,443)**	22,515
Proceeds from FHLB advances		170,400
Repayment of FHLB advances	**(18,000)**	(150,007)
Issuance of preferred stock and warrants, net of issuance costs	**64,632**	
Repurchase of preferred stock and warrants	**(66,179)**	
Common stock issuance	**29,395**	160
Common stock repurchased	**(179)**	(72)
Dividends paid on preferred stock	**(1,115)**	
Dividends paid on common stock	**(3,853)**	(3,464)
Stock options exercised		98
Net cash provided by financing activities	**26,351**	168,587
Net increase in cash and cash equivalents	**107,627**	9,205
Cash and cash equivalents at beginning of period	**49,465**	95,333
Cash and cash equivalents at end of period	$ **157,092**	$ 104,538
Supplemental Disclosures:		
Cash paid for:		
Interest	$ **22,244**	$ 32,969
Income taxes	$ **5,154**	$ 6,907

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

SCBT Financial Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain prior period information has been reclassified to conform to the current period presentation, and these reclassifications had no impact on net income or equity as previously reported. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

The condensed consolidated balance sheet at December 31, 2008, has been derived from the audited financial statements at that date, but does not include all of the information and disclosures required by accounting principles generally accepted in the United States for complete financial statements.

The information contained in the consolidated financial statements and accompanying notes included in SCBT Financial Corporation s (the Company) annual report on Form 10-K for the year ended December 31, 2008 should be referenced when reading these unaudited condensed consolidated financial statements.

Subsequent events have been evaluated through August 10, 2009, which is the date of financial statement issuance.

Note 2 Recent Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement No. 165, *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The Company adopted the provisions of Statement 165 during the period ended June 30, 2009 which did not impact its financial statements. The Company evaluated all events or transactions that occurred after June 30, 2009, through August 10, 2009, the date the Company issued these financial statements. During this period the Company did not have any material recognizable subsequent events that required recognition in the Company s disclosures to the June 30, 2009 financial statements.

In April 2009, the FASB issued a FASB Staff Position (FSP) 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. The FSP allows an entity to determine whether a market is not active for a financial asset, considered in relation to normal market activity for that asset, using a list of factors provided in the FSP to aid in making that assessment. If, after evaluating the relevant factors, the evidence indicates the market is not active, the entity would determine whether a quoted price in that market is associated with a distressed transaction. The determination of whether transactions are distressed should be based on the weight of the available evidence. The FSP provides illustrative circumstances that could indicate that a transaction is not orderly (i.e., distressed). More weight should be placed on transactions that are orderly and less weight placed on transactions that are not orderly. The FSP requires new disclosures relating to fair value measurement inputs and valuation techniques (including changes in inputs and valuation techniques). The FSP is effective for periods ending after June 15, 2009 with early adoption permitted. The Company had previously determined that transactions in the market for it s pooled trust preferred securities were disorderly using guidance from FSP FAS 157-3, *Determining the Fair Value of a Financial Asset when the market for that Asset is not Active*. Therefore the adoption of FSP FAS 157-4 did not have a material impact on the Company s results of operations.

Table of Contents

Note 2 Recent Accounting Pronouncements (continued)

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. The guidance in this FSP will change (1) the method for determining whether an other-than-temporary impairment exists for debt securities and (2) the amount of an impairment charge to be recorded in earnings. To determine whether an other-than-temporary impairment exists, an entity will assess the likelihood of selling the security prior to recovering its cost basis. This is a change from the current requirement for an entity to assess whether it has the intent and ability to hold a security to recovery. If the entity intends to sell the debt security or it is more-likely-than-not that the entity will be required to sell the debt security prior to recovering its cost basis, the security should be written down to fair value with the full charge recorded in earnings. If the entity does not intend to sell the debt security and it is not more-likely-than-not that the entity will be required to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there are credit losses associated with the security. In that case: (1) where credit losses exist, the portion of the impairment related to those credit losses should be recognized in earnings; (2) any remaining difference between the fair value and the cost basis should be recognized as part of other comprehensive income. The entity will be required to present on the face of the income statement both the total of any other-than-temporary impairment loss, and the noncredit portion recorded in other comprehensive income as an adjustment thereto. The entity is required to provide enhanced disclosures, including its methodology and key inputs used for determining the amount of credit losses recorded in earnings. On adoption, the noncredit portion of an other-than-temporary impairment previously recognized in retained earnings should be reclassified to other comprehensive income as a cumulative effect adjustment if the entity does not intend to sell the debt security and it is not more-likely-than-not that the entity will be required to sell the security prior to recovery. The impairment model for equity securities is unaffected by this FSP. The FSP is effective for periods ending after June 15, 2009 with early adoption permitted. See Note 3 Investment Securities for the effect of the adoption of FSP No. FAS 115-2 and FAS 124-2.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. The FSP will increase the frequency of fair value disclosures from annual only to quarterly to provide financial statement users with more timely information about the effects of current market conditions on their financial instruments. The FSP requires public entities to disclose in their interim financial statements the fair value of all financial instruments within the scope of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, as well as the method(s) and significant assumptions used to estimate the fair value of those financial instruments. The FSP is effective for periods ending after June 15, 2009 with early adoption permitted. While the Company expanded its disclosure in accordance with FSP FAS 107-1 and APB 28-1, its adoption did not have a material impact on the Company s results of operations.

In April 2009, the FASB issued FSP No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. The FSP amends and clarifies the accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. Assets acquired and liabilities assumed in a business combination that arise from contingencies should be recognized at fair value on the acquisition date if fair value can be determined during the measurement period. If fair value can not be determined, companies should typically account for the acquired contingencies using existing guidance. Contingent consideration arrangements of an acquiree assumed by the acquirer as part of a business combination will be accounted for as contingent consideration by the acquirer. The guidance is effective for fiscal years beginning after December 15, 2008. The Company will prospectively apply the FSP to all business combinations completed on or after January 1, 2009. The Company has no business combinations currently scheduled.

In June 2008, the FASB issued a FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. The guidance in this FSP applies to the calculation of earnings per share (EPS) under Statement 128 for share-based payment awards with rights to dividends or dividend equivalents. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. This FSP is effective for financial statements issued in fiscal years beginning after December 15, 2008. Adoption of FSP EITF 03-6-1 did not have a significant impact on the Company s EPS calculation and related disclosures.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Adoption of FSP 142-3 will be prospective on any future acquisitions by the Company.

Table of Contents

Note 2 Recent Accounting Pronouncements (continued)

In February 2008, the FASB issued FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*. FSP FAS 157-2 deferred the effective date of the disclosure requirement for nonfinancial assets and nonfinancial liabilities by FAS 157 until the beginning the first quarter of 2009. The Company has adopted FAS 157-2 (see Note 10 Fair Value).

Note 3 Investment Securities

The following is the amortized cost and fair value of investment securities held to maturity:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2009:				
State and municipal obligations	**$ 22,356**	**$ 88**	**$ (696)**	**$ 21,748**
December 31, 2008:				
State and municipal obligations	$ 24,228	$ 84	$ (735)	$ 23,577

The values are based on data, which often reflect transactions of relatively small size and are not necessarily indicative of the value of the securities when traded in large volumes.

The following is the amortized cost and fair value of investment securities available for sale:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2009:				
Government-sponsored enterprises debt *	**$ 11,477**	**$ 246**	**$**	**$ 11,723**
State and municipal obligations	**19,146**	**70**	**(1,100)**	**18,116**
Mortgage-backed securities **	**109,736**	**4,003**		**113,739**
Trust preferred (collateralized debt obligations)	**16,447**		**(6,745)**	**9,702**
Corporate stocks	**369**	**208**	**(214)**	**363**
	$ 157,175	**$ 4,527**	**$ (8,059)**	**$ 153,643**
December 31, 2008:				
Government-sponsored enterprises debt *	$ 28,207	$ 465	$	$ 28,672
State and municipal obligations	11,449	8	(899)	10,558
Mortgage-backed securities **	130,009	3,510	(14)	133,505
Trust preferred (collateralized debt obligations)	17,011		(6,928)	10,083
Corporate stocks	369	35	(2)	402
	$ 187,045	$ 4,018	$ (7,843)	$ 183,220

* - Government-sponsored enterprises are comprised of debt securities offered by Federal Home Loan Mortgage Corporation (FHLMC) or Freddie Mac, Federal National Mortgage Association (FNMA) or Fannie Mae, Federal Home Loan Bank (FHLB), and Federal Farm Credit Banks (FFCB).

** - Mortgage-backed securities are issued by government-sponsored enterprises.

The amortized cost and fair value of investment securities at June 30, 2009 by contractual maturity are detailed below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

	Held to Maturity		Available for Sale	
(Dollars in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 1,551	$ 1,579	$ 4,292	$ 4,388
Due after one year through five years	748	755	16,172	16,592
Due after five years through ten years	3,635	3,676	34,871	36,146
Due after ten years	16,422	15,738	101,840	96,517
	$ 22,356	$ 21,748	$ 157,175	$ 153,643

Table of Contents

Note 3 Investment Securities (continued)

Information pertaining to the Company s securities available for sale with gross unrealized losses at June 30, 2009 and December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position is as follows:

	Less Than Twelve Months		Twelve Months or More	
(Dollars in thousands)	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**
June 30, 2009:				
Securities Held to Maturity				
State and municipal obligations	**$ 696**	**$ 16,747**	**$**	**$**
Securities Available for Sale				
Government-sponsored enterprises debt	**$**	**$**	**$**	**$**
State and municipal obligations	**1,100**	**14,520**		
Mortgage-backed securities				
Trust preferred (collateralized debt obligations)			**6,745**	**9,702**
Corporate stocks	**214**	**163**		
	$ 1,314	**$ 14,683**	**$ 6,745**	**$ 9,702**
December 31, 2008:				
Securities Held to Maturity				
State and municipal obligations	$ 735	$ 17,944	$	$
Securities Available for Sale				
Government-sponsored enterprises debt	$	$	$	$
State and municipal obligations	899	10,014		
Mortgage-backed securities	11	2,767	3	1,503
Trust preferred (collateralized debt obligations)	3,408	6,452	3,522	3,949
	$ 4,318	$ 19,233	$ 3,525	$ 5,452

The following table presents a rollforward of the amount of credit losses on the Company s investment securities recognized in earnings for the six months ended June 30, 2009:

(Dollars in thousands)	
Beginning balance of credit losses previously recognized in earnings	$
Amount related to credit loss for securities which an other-than-temporary impairment was not previously recognized in earnings	
Amount related to credit loss for securities which an other-than-temporary impairment was recognized in earnings	**544**
Ending balance of cumulative credit losses recognized in earnings	**$ 544**

During the three months ended June 30, 2009, the Company adopted FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-than-Temporary Impairment,* which requires that credit related other-than-temporary impairment (OTTI) on debt securities be recognized in earnings while noncredit related OTTI on debt securities not expected to be sold be recognized in other comprehensive income (OCI). As a result of its analysis, the Company recorded $544,000 in credit-related OTTI charges in earnings. This OTTI charge in earnings was taken on two pooled trust preferred collateralized debt obligations (TRUPs) that are classified as available for sale securities. In addition, the Company recognized $1.2 million, or $1.9 million on a pre-tax basis, for the non-credit impairment associated with the same two TRUPs in OCI (in equity).

Table of Contents

Note 3 Investment Securities (continued)

On at least a quarterly basis, the Company reviews its investment portfolio for indications of impairment. This review includes analyzing the length of time and the extent to which fair value has been lower than the cost, the financial condition and near-term prospects of the issuers, including any specific events which may influence the operations of the issuers. The Company evaluates its intent and ability to hold investments for a period of time sufficient to allow for any anticipated recovery in the market, including consideration of our investment strategy, our cash flow needs, liquidity position, capital adequacy and interest rate risk position. Additionally, the risk of further OTTI charges may be influenced by additional bank failures, prolonged recession of the U.S. economy, changes in real estate values, interest deferrals, and whether the federal government continues to provide financial assistance to financial institutions.

The TRUPs represent beneficial interests in securitized financial assets that the Company analyzes within the scope of EITF 99-20 (as amended), and are evaluated for OTTI using management s best estimates of future cash flows. If these estimated cash flows determine that it is probable an adverse change in the discounted present value of future cash flows has occurred, then an OTTI charge would be recognized in accordance with FSP FAS 115-2 and FAS 124-2. There is risk that this quarterly review could result in the Company recording OTTI charges in the future.

At June 30, 2009, the book value of the Company s TRUPs totaled $16.4 million with an estimated fair value of $9.7 million. One of these securities is a senior tranche (MMCaps I A) and the remaining seven securities are mezzanine tranches. As of March 31, 2009, all of these securities were downgraded by both Moody s and Fitch, except for the MMCaps I A security which is rated A3/AAA. There have been no further changes in the securities ratings as of June 30, 2009.

As of June 30, 2009, the following table provides detail of the Company s pooled TRUPs, which all have been in an unrealized loss position greater than twelve months:

(Dollars in thousands)	Class	# of Issuers	Book Value	Fair Value	Unrealized Loss	Credit Ratings (1)	Receiving Principal / Interest Contractually? (2)		Deferral / Defaults % of Total Collateral Balance (3)	Excess Subordination as a % of Current Performing Collateral (4)
PreTSL IX B-3	Mezzanine	51	$ 2,983	$ 1,529	$ (1,454)	Ca / CC	Yes / Yes		22.3%	10.6%
PreTSL X B-1	Mezzanine	58	3,073	1,553	(1,520)	Ca / CC	Yes / Yes	(5)	24.7%	3.6%
PreTSL X B-3	Mezzanine	58	862	445	(417)	Ca / CC	Yes / Yes	(5)	24.7%	3.6%
PreTSL XVI C	Mezzanine	58	1,004	228	(776)	Ca / CC	Yes / No		18.5%	11.6%
PreTSL XI B-1	Mezzanine	67	3,000	1,922	(1,078)	Ca / CC	Yes / Yes		14.4%	15.7%
PreTSL XIII B-2	Mezzanine	68	1,000	528	(472)	Ca / CC	Yes / Yes		15.1%	12.8%
PreTSL XIV B-2	Mezzanine	63	1,800	1,288	(512)	Ca / CC	Yes / Yes		10.7%	17.9%
MMCaps I A	Senior	29	2,725	2,209	(516)	A3 / AAA	Yes / Yes		9.2%	32.6%
Total			$ 16,447	$ 9,702	$ (6,745)					

Notes to table above:

(1) Credit Ratings represent Moody's and Fitch (S&P does not rate these securities).

(2) Interest on this security is currently not being paid in cash, but is being added (capitalized) to the bond balance, a process known as a payment in kind (PIK). This is the result of a current, temporary interest shortfall being experienced due to the amount of deferrals/defaults to prevent within the given deal, and therefore, there is not enough interest available to pay the current interest on the given class of notes or breaching the principal coverage test of the class of notes immediately senior to the given class. The Company has one TRUPs, PreTSL XVI C, which is PIKing.

(3) This ratio represents the amount of deferrals/defaults that is known or projected for the following quarter to the total amount of collateral for a given deal. Fewer deferrals/defaults produce a lower ratio.

(4) Excess Subordination amount is the additional defaults/deferrals necessary to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a break in yield. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The percent of current performing collateral is the ratio of the excess subordination amount to current performing collateral a higher percent means there is more excess subordination to absorb additional defaults/deferrals, and the better our security is protected from a shortfall in projected cash flows.

(5) As of July 31, 2009, the company became aware that PreTSL X B-1 and PreTSL X B-3 are now partially PIKing.

Table of Contents

Note 3 Investment Securities (continued)

When evaluating TRUPs for OTTI, the Company determines a credit related portion and a noncredit related portion. The credit related portion is recognized in earnings and represents the net present value of the expected shortfall in future cash flows. The noncredit related portion is recognized in other comprehensive income, and represents the difference between the book value and the fair value of the security less the amount of the credit related impairment. A discounted cash flow analysis under EITF 99-20 provides the best estimate of credit related OTTI for these securities. The determination of whether it is probable that an adverse change in estimated cash flows has occurred is evaluated by comparing the present value of the estimated cash flows previously projected (at March 31, 2009) with the present value of the projected remaining cash flows at June 30, 2009. The Company considers this cash flow analysis to be its primary evidence when determining whether credit related OTTI exists.

Results of a discounted cash flow test are significantly affected by other variables such as the estimate of future cash flows, credit worthiness of the underlying issuers and determination of the likelihood of defaults of the underlying collateral. The following provides additional information for each of these variables:

- Estimate of future cash flows Cash flows are constructed in an INTEX cash flow model. This is a proprietary cash flow model typical of industry standards for analyzing all types of collateralized debt obligations. It includes each deal s structural features updated with trustee information, including asset-by-asset detail, as it becomes available. The modeled cash flows are then used to estimate if all the contractual principal and interest payments of the Company s investment will be made. The discount rate used is equal to current yield used to accrete the beneficial interest under EITF 99-20 paragraph 12b.

- Collateral and credit analysis A quarterly collateral and credit evaluation is performed for each of the financial institutions that have issued TRUPs within each pool. The evaluation considers all evidence available to the Company and includes the issuer s business, its years of operation, loan composition, and geographic footprint. The Company s analysis focuses primarily on earnings trends, profitability, shareholders equity, asset quality ratios (including Texas ratio analysis), capital adequacy, and participation in TARP.

- Defaults / recoveries For all eight of the Company s TRUPs, issuers currently in default or deferring interest payments are assigned 100% probability of default. For all other issuers, the default rate for performing collateral is updated quarterly, and was based upon the worst five year (1988-1992) bank failure period since 1934, the end of the Great Depression. The result of this assumption was 11.5% in defaults over the next five years on top of deferrals previously encountered in prior periods; and .25% annually thereafter (until maturity). In all cases, a 15% recovery rate is applied to projected defaults with a two year lag.

- Likelihood of additional defaults The Company s evaluation of impairment also includes a stress test analysis that provides an estimate of the sufficiency of performing collateral to provide the contractual cash flows for each tranche. The Company determines the additional defaults necessary to result in an adverse change to expected cash flows. This breakpoint is used to calculate the excess subordination for each of the Company s pooled TRUPs before a break in yield (i.e., that point where not all contractual cash flows are expected to be received). Then, the Company compares this excess subordination amount against our collateral and credit analysis (as explained above).

Based upon the analysis performed by management as of June 30, 2009, the Company deemed it probable that it will collect all contractual principal and interest payments on all of its TRUPs, except for PreTSL X B-1 and PreTSL X B-3. The analysis on these two securities resulted in a $544,000 credit-related OTTI charge during the three months ended June 30, 2009.

Table of Contents

Note 4 Loans and Allowance for Loan Losses

The Company's loan portfolio is comprised of the following:

(Dollars in thousands)	June 30, 2009	December 31, 2008	June 30, 2008
Commercial real estate:			
Construction and land development	**$ 489,730**	$ 535,638	$ 558,375
Commercial non-owner occupied	**318,909**	330,792	305,307
Total commercial real estate	**808,639**	866,430	863,682
Consumer real estate:			
Consumer owner occupied	**289,423**	293,521	274,206
Home equity loans	**239,250**	222,025	199,191
Total consumer real estate	**528,673**	515,546	473,397
Total real estate	**1,337,312**	1,381,976	1,337,079
Commercial owner occupied real estate	**456,973**	423,345	381,488
Commercial and industrial	**214,384**	251,929	249,593
Other income producing property	**136,098**	141,516	126,625
Consumer	**79,386**	95,098	106,580
Other loans	**12,009**	22,212	44,988
Total loans	**2,236,162**	2,316,076	2,246,353
Less, allowance for loan losses	**(32,431)**	(31,525)	(28,760)
Loans, net	**$ 2,203,731**	$ 2,284,551	$ 2,217,593

An analysis of the changes in the allowance for loan losses is as follows:

(Dollars in thousands)	June 30, 2009	2008
Balance at beginning of period	**$ 31,525**	$ 26,570
Loans charged-off	**(9,518)**	(1,884)
Recoveries of loans previously charged-off	**860**	497
Net charge-offs	**(8,658)**	(1,387)
Provision for loan losses	**9,564**	3,577
Balance at end of period	**$ 32,431**	$ 28,760

At June 30, 2009 and 2008, there were $23.3 million and $9.1 million, respectively, of loans classified as impaired under the definition outlined in SFAS No. 114 *Accounting By Creditors For Impairment of a Loan*. Specific reserves allocated to these impaired loans totaled $2.5 million and $320,000 at June 30, 2009 and 2008, respectively. At June 30, 2009, there were approximately $13.8 million of impaired loans with specific reserves. At June 30, 2009, there were approximately $9.5 million in impaired loans for which no specific reserve had been recognized. The average recorded investments in impaired loans for the quarters ended June 30, 2009 and 2008 were $19.2 million and $573,000, respectively.

Table of Contents

Note 5 Deposits

The Company s total deposits are comprised of the following:

(Dollars in thousands)		June 30, 2009		December 31, 2008		June 30, 2008
Certificates of deposit	**$**	**1,026,260**	$	1,131,828	$	1,020,414
Interest-bearing demand deposits		**671,635**		575,991		567,510
Demand deposits		**322,270**		303,689		322,209
Savings deposits		**158,519**		141,379		145,262
Other time deposits		**1,682**		387		1,451
Total deposits	**$**	**2,180,366**	$	2,153,274	$	2,056,846

The aggregate amount of time deposits in denominations of $100,000 or more at June 30, 2009, December 31, 2008, and June 30, 2008 was $523.5 million, $510.2 million and $500.1 million, respectively. The Company had brokered certificates of deposits of $10.0 million, $110.0 million and $25.6 million, respectively, at June 30, 2009, December 31, 2008, and June 30, 2008.

Note 6 Participation in U.S. Treasury Capital Purchase Program

On May 20, 2009, the Company entered into a repurchase letter agreement with the United States Department of the Treasury, pursuant to which the Company repurchased all 64,779 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series T, having a liquidation preference of $1,000 per share for an aggregate purchase price of approximately $64.8 million, which included accrued and unpaid dividends of approximately $45,000. Previously, on January 16, 2009, the Company issued and sold the Preferred Shares, along with a warrant to purchase 303,083 shares of the Company s common stock, to the Treasury for an aggregate purchase price of $64.8 million as part of the Treasury s Troubled Assets Relief Program Capital Purchase Program, pursuant to a Purchase Letter Agreement.

The Company recognized a charge of approximately $3.3 million for the three months ended June 30, 2009 in the form of an accelerated dividend to account for the difference between the original purchase price for the preferred stock and its redemption price. In addition to this charge, the Company recognized a dividend on the preferred stock including the accretion on the preferred stock discount of approximately $549,000, for a total effective dividend of approximately $3.9 million for the three months ended June 30, 2009, charged to net income available to common shareholders.

On June 24, 2009, the Company entered into an agreement with the Treasury to repurchase the warrant that was issued to the Treasury in connection with the preferred stock. Pursuant to the terms of the agreement, the Company repurchased the warrant for a purchase price of $1.4 million. As a result of the warrant repurchase, the Company has repurchased all securities issued to the Treasury under the Capital Purchase Program.

12

Table of Contents

Note 7 Retirement Plans

The Company and its subsidiaries provide certain retirement benefits to their employees in the form of a non-contributory defined benefit pension plan and an employees savings plan. The non-contributory defined benefit pension plan covers all employees hired on or before December 31, 2005, who have attained age 21, and who have completed one year of eligible service. Employees hired on or after January 1, 2006 are not eligible to participate in the non-contributory defined benefit pension plan. On this date, a new benefit formula applies only to participants who have not attained age 45 or who do not have five years of service. During the three months ended June 30, 2009, the Company suspended the accrual of benefits for plan participants under the non-contributory defined benefit plan and recorded a curtailment gain in earnings of $782,000, before tax, and a change in pension liability for plan curtailment of $1.3 million, net of tax, in other comprehensive income.

The components of net periodic pension expense recognized during the three and six months ended June 30 are as follows:

(Dollars in thousands)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Service cost	**$ 189**	$ 165	**$ 378**	$ 331
Interest cost	**289**	258	**578**	516
Expected return on plan assets	**(352)**	(336)	**(704)**	(671)
Amortization of prior service cost	**(43)**	(43)	**(86)**	(86)
Recognized net actuarial loss	**121**	79	**242**	157
Net periodic pension expense	**$ 204**	$ 123	**$ 408**	$ 247

The Company contributed $340,000 and $700,000 to the pension plan for the three and six months ended June 30, 2009 and anticipates making similar additional quarterly contributions during the remainder of the year.

Electing employees are eligible to participate in the employees savings plan, under the provisions of Internal Revenue Code Section 401(k), after attaining age 21. Plan participants elect to contribute portions of their annual base compensation as a before tax contribution. The Company matches 50% of these contributions up to a 6% employee contribution for employees hired before January 1, 2006 who were age 45 and higher with five or more vesting years of service. The Company matches 100% of these contributions up to a 6% employee contribution for current employees under age 45 or with less than five years of service. Employees hired on January 1, 2006 or thereafter will not participate in the defined benefit pension plan, but are eligible to participate in the employees savings plan and the Company matches 100% of the employees contributions up to a 6%. Effective April 1, 2009, the Company temporarily suspended the employer match contribution to all participants in the plan.

Employees can enter the savings plan on or after the first day of each month. The employee may enter into a salary deferral agreement at any time to select an alternative deferral amount or to elect not to defer in the Plan. If the employee does not elect an investment allocation, the plan administrator will select a retirement-based portfolio according to the employee s number of years until normal retirement age. The plan s investment valuations are generally provided on a daily basis.

13

Table of Contents

Note 8 Earnings Per Share

Basic earnings per share are calculated by dividing net income available to common shareholders by the weighted-average shares of common stock outstanding during each period. The Company s diluted earnings per share are based on the weighted-average shares of common stock outstanding during each period plus the maximum dilutive effect of common stock issuable upon exercise of stock options or vesting of restricted shares. The weighted-average number of shares and equivalents are determined after giving retroactive effect to stock dividends and stock splits.

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars and shares in thousands)	**2009**	**2008**	**2009**	**2008**
Basic earnings per share:				
Net income available to common shareholders	**$ 1,525**	$ 6,149	**$ 5,231**	$ 12,112
Weighted-average basic shares	**11,827**	10,110	**11,516**	10,105
Basic earnings per share	**$ 0.13**	$ 0.61	**$ 0.45**	$ 1.20
Diluted earnings per share:				
Net income available to common shareholders	**$ 1,525**	$ 6,149	**$ 5,231**	$ 12,112
Weighted-average basic shares	**11,827**	10,110	**11,516**	10,105
Effect of dilutive securities	**44**	143	**44**	134
Weighted-average dilutive shares	**11,871**	10,253	**11,560**	10,239
Diluted earnings per share	**$ 0.13**	$ 0.60	**$ 0.45**	$ 1.18

The calculation of diluted earnings per share excludes outstanding stock options that have exercise prices greater than the average market price of the common shares for the year as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	**2009**	**2008**	**2009**	**2008**
Number of shares	261,023	45,545	259,810	58,145
Range of exercise prices	$23.50 - $39.74	$34.65 - $39.74	$24.13 - $39.74	$32.25 - $39.74

Table of Contents

Note 9 Share-Based Compensation

The Company s 1999 and 2004 stock option programs are long-term retention programs intended to attract, retain, and provide incentives for key employees and non-employee directors in the form of incentive and non-qualified stock options and restricted stock.

Stock Options

With the exception of non-qualified options granted to directors under the 1999 and 2004 plans, which in some cases may be exercised at any time prior to expiration and in some other cases may be exercised at intervals less than one year following the grant date, incentive stock options granted under the plans may not be exercised in whole or in part within one year following the date of the grant, as these incentive stock options become exercisable in 25% increments ratably over the four year period following the grant date. The options are granted at an exercise price at least equal to the fair value of the common stock at the date of grant and have terms ranging from five to ten years. No options were granted under the 1999 plan after January 2, 2004, and the plan is closed other than for any options still unexercised and outstanding. The 2004 plan is the only plan from which new share-based compensation grants may be issued. It is the Company s policy to grant options out of the 661,500 shares registered under the 2004 plan.

Activity in the Company s stock option plans is summarized in the following table. All information has been retroactively adjusted for stock dividends and stock splits.

Options	**Number of Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Life (Yrs.)**	**Aggregate Intrinsic Value (000 s)**
Outstanding at January 1, 2009	351,553	$ 26.94		
Granted	31,288	27.57		
Exercised				
Expired/Forfeited				
Outstanding at June 30, 2009	382,841	26.99	5.27	$ 673
Exercisable at June 30, 2009	309,555	25.85	4.52	$ 673
Weighted-average fair value of options granted during the year	$ 9.72			

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options vesting periods. The following weighted-average assumptions were used in valuing options issued:

Three Months Ended June 30,

	2009	2008
Dividend yield	**2.00%**	1.87%
Expected life	**6 years**	6 years
Expected volatility	**45%**	37%
Risk-free interest rate	**1.82%**	3.44%

As of June 30, 2009, there was $565,000 of total unrecognized compensation cost related to nonvested stock option grants under the plans. The cost is expected to be recognized over a weighted-average period of 1.52 years as of June 30, 2009. The total fair value of shares vested during the six months ended June 30, 2009 was $303,000.

Table of Contents

Note 9 Share-Based Compensation (continued)

Restricted Stock

The Company from time-to-time also grants shares of restricted stock to key employees and non-employee directors. These awards help align the interests of these employees and directors with the interests of the shareholders of the Company by providing economic value directly related to increases in the value of the Company s stock. The value of the stock awarded is established as the fair market value of the stock at the time of the grant. The Company recognizes expenses, equal to the total value of such awards, ratably over the vesting period of the stock grants. Grants to employees have typically vested over a 48-month period, and beginning in 2007, some grants cliff vest after four years. Also, some grants issued during 2008 to certain employees cliff vest after ten years. Grants to non-employee directors typically vest within a 12-month period. On January 22, 2009, the Company issued 69,600 shares of restricted stock to replace the cash-based Supplemental Executive Retirement Plan agreements for three executives of the Company. These grants vest on December 31 of each year with final vesting at the end of the month in which the executive reaches his retirement age of 60 years old.

Nonvested restricted stock for the six months ended June 30, 2009 is summarized in the following table. All information has been retroactively adjusted for stock dividends and stock splits.

Restricted Stock	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2009	99,557	$ 31.57
Granted	89,258	26.81
Vested	(25,109)	27.24
Forfeited	(2,698)	32.75
Nonvested at June 30, 2009	161,008	29.58

As of June 30, 2009, there was $3.8 million of total unrecognized compensation cost related to nonvested restricted stock granted under the plans. This cost is expected to be recognized over a weighted-average period of 5.3 years as of June 30, 2009. The total fair value of shares vested during the six months ended June 30, 2009 was $684,000.

Note 10 Commitments and Contingent Liabilities

In the normal course of business, the Company makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying financial statements. The commitments and contingent liabilities include guarantees, commitments to extend credit, and standby letters of credit. At June 30, 2009, commitments to extend credit and standby letters of credit totaled $509.5 million. The Company does not anticipate any material losses as a result of these transactions.

Note 11 Fair Value

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, (SFAS 157), which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Table of Contents

Note 11 Fair Value (continued)

SFAS 157 establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable inputs such as quoted prices in active markets;

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Following is a description of valuation methodologies used for assets recorded at fair value.

Investment Securities

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Federal Reserve Bank and Federal Home Loan Bank stock approximates fair value based on their redemption provisions.

Pooled trust preferred securities are Level 3 securities under FAS 157 s three-tier fair value hierarchy because of an absence of observable inputs for these and similar securities in the debt markets. The Company has determined that (1) there are few observable transactions and market quotations available are not reliable for purposes in determining fair value at June 30, 2009, and (2) an income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than the market approach valuation technique used at prior measurement dates. This income valuation approach requires numerous steps in determining fair value. These steps include estimating credit quality of the collateral, generating asset defaults, forecasting cash flows for underlying collateral, and determining losses given default assumption.

Mortgage Loans Held for Sale

Mortgage loans held for sale are carried at the lower of cost or market value. The fair values of mortgage loans held for sale are based on commitments on hand from investors within the secondary market for loans with similar characteristics. As such, the fair value adjustments for mortgage loans held for sale is nonrecurring Level 2.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be 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*, (SFAS 114). 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 June 30, 2009, substantially all of the 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 considers 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 considers the impaired loan as nonrecurring Level 3.

Table of Contents

Note 11 Fair Value (continued)

Other Real Estate Owned (OREO)

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of OREO expense.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

(Dollars in thousands)	Fair Value June 30, 2009	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale:				
Government-sponsored enterprises debt	$ 11,723	$	$ 11,723	$
State and municipal obligations	18,116		18,116	
Mortgage-backed securities	113,739			