EAGLE BANCORP INC
Form 10-Q
November 07, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 September 30, 2012

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 0-25923

Eagle Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	52-2061461 (I.R.S. Employer Identification No.)
7815 Woodmont Avenue, Bethesda, Maryland (Address of principal executive offices)	20814 (Zip Code)

(301) 986-1800
(Registrant's telephone number, including area code)

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

Indicate by check 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. Yesx Noo

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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). Yesx Noo

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 filero	Accelerated filerx	Non-accelerated filer o	Smaller Reporting Companyo

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 the issuer's classes of common stock, as of the latest practicable date.

As of October 31, 2012, the registrant had 22,894,721 shares of Common Stock outstanding.

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Item 1 – Financial Statements (Unaudited)

EAGLE BANCORP, INC.
Consolidated Balance Sheets (Unaudited)
(dollars in thousands, except per share data)

	September 30, 2012	December 31, 2011	September 30, 2011
Assets			
Cash and due from banks	$6,780	$5,374	$5,914
Federal funds sold	4,173	21,785	22,088
Interest bearing deposits with banks and other short-term investments	46,752	205,252	718,848
Investment securities available for sale, at fair value	296,363	313,811	292,257
Federal Reserve and Federal Home Loan Bank stock	12,031	10,242	9,430
Loans held for sale	171,241	176,826	107,907
Loans	2,397,669	2,056,256	2,029,645
Less allowance for credit losses	(35,582)	(29,653)	(28,599)
Loans, net	2,362,087	2,026,603	2,001,046
Premises and equipment, net	14,472	12,320	11,162
Deferred income taxes	16,413	14,673	14,091
Bank owned life insurance	14,036	13,743	13,643
Intangible assets, net	3,895	4,145	4,154
Other real estate owned	4,923	3,225	2,941
Other assets	23,022	23,256	16,265
Total Assets	$2,976,188	$2,831,255	$3,219,746
Liabilities and Shareholders' Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$796,654	$688,506	$1,106,689
Interest bearing transaction	112,901	80,105	69,762
Savings and money market	1,180,894	1,068,370	986,585
Time, $100,000 or more	242,159	332,470	351,128
Other time	182,381	222,644	233,185
Total deposits	2,514,989	2,392,095	2,747,349
Customer repurchase agreements	75,368	103,362	147,671
Other short-term borrowings	10,000	-	-
Long-term borrowings	39,300	49,300	49,300
Other liabilities	12,132	19,787	16,964
Total Liabilities	2,651,789	2,564,544	2,961,284
Shareholders' Equity			
Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series B, $1,000 per share liquidation preference, shares issued and outstanding 56,600 at September 30, 2012, December 31, 2011 and September 30, 2011	56,600	56,600	56,600
	217	197	197

Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 22,040,006, 19,952,844 and 19,890,957, respectively			
Warrant	946	946	946
Additional paid in capital	164,522	132,670	131,946
Retained earnings	96,088	71,423	64,389
Accumulated other comprehensive income	6,026	4,875	4,384
Total Shareholders' Equity	324,399	266,711	258,462
Total Liabilities and Shareholders' Equity	$2,976,188	$2,831,255	$3,219,746

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Operations (Unaudited)
(dollars in thousands, except per share data)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2012	2011	2012	2011
Interest Income				
Interest and fees on loans	$98,161	$81,013	$34,805	$29,119
Interest and dividends on investment securities	5,279	4,754	1,735	1,469
Interest on balances with other banks and short-term investments	298	172	83	136
Interest on federal funds sold	41	94	13	17
Total interest income	103,779	86,033	36,636	30,741
Interest Expense				
Interest on deposits	9,130	13,121	2,722	4,613
Interest on customer repurchase agreements	250	533	68	212
Interest on short-term borrowings	2	-	2	-
Interest on long-term borrowings	1,605	1,603	536	540
Total interest expense	10,987	15,257	3,328	5,365
Net Interest Income	92,792	70,776	33,308	25,376
Provision for Credit Losses	12,051	8,218	3,638	2,887
Net Interest Income After Provision For Credit Losses	80,741	62,558	29,670	22,489
Noninterest Income				
Service charges on deposits	2,902	2,301	988	880
Gain on sale of loans	9,867	3,872	3,144	1,065
Gain on sale of investment securities	765	1,445	464	854
Loss on early extinguishment of debt	(529)	-	(529)	-
Increase in the cash surrender value of bank owned life insurance	294	301	100	100
Other income	2,005	1,718	684	612
Total noninterest income	15,304	9,637	4,851	3,511
Noninterest Expense				
Salaries and employee benefits	31,520	24,335	10,807	9,263
Premises and equipment expenses	7,541	5,982	2,562	1,939
Marketing and advertising	1,340	1,215	497	234
Data processing	3,273	2,477	1,066	876
Legal, accounting and professional fees	3,315	2,870	1,073	731
FDIC insurance	1,553	1,628	485	285
Other expenses	7,664	6,462	2,617	2,395
Total noninterest expense	56,206	44,969	19,107	15,723
Income Before Income Tax Expense	39,839	27,226	15,414	10,277
Income Tax Expense	14,748	9,842	5,739	3,783
Net Income	25,091	17,384	9,675	6,494
Preferred Stock Dividends and Discount Accretion	425	1,369	142	166
	$24,666	$16,015	$9,533	$6,328

Net Income Available to Common Shareholders				
Earnings Per Common Share				
Basic	$1.20	$0.81	$0.45	$0.32
Diluted	$1.17	$0.79	$0.44	$0.31

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Comprehensive Income (Unaudited)
(dollars in thousands)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2012	2011	2012	2011
Net Income	$25,091	$17,384	$9,675	$6,494
Other comprehensive income, net of tax:				
Net unrealized gain on securities available for sale	1,610	3,193	911	1,681
Reclassification adjustment for net gains included in net income	(459)	(867)	(278)	(512)
Net change in unrealized gains on securities	1,151	2,326	633	1,169
Comprehensive Income	$26,242	$19,710	$10,308	$7,663

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(dollars in thousands, except per share data)

	Preferred Stock	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2012	$ 56,600	$ 197	$ 946	$ 132,670	$ 71,423	$ 4,875	$ 266,711
Net Income	-	-	-	-	25,091	-	25,091
Net change in other comprehensive income	-	-	-	-	-	1,151	1,151
Stock-based compensation	-	-	-	2,060	-	-	2,060
Common stock issued 316,577 shares under purchase and equity compensation plans	-	2	-	1,223	-	-	1,225
Shares issued in public offering 1,770,585 shares, net of of issuance costs of $1,384	-	18	-	28,482	-	-	28,500
Tax benefits related to non-qualified stock compensation	-	-	-	87	-	-	87
Preferred stock:							
Preferred stock dividends	-	-	-	-	(426)	-	(426)
Balance, September 30, 2012	$ 56,600	$ 217	$ 946	$ 164,522	$ 96,088	$ 6,026	$ 324,399
Balance, January 1, 2011	$ 22,582	$ 197	$ 946	$ 130,382	$ 48,551	$ 2,058	$ 204,716
Net Income	-	-	-	-	17,384	-	17,384
Net change in other comprehensive income	-	-	-	-	-	2,326	2,326
Stock-based compensation	-	-	-	818	-	-	818
Common stock issued 114,624 shares under purchase and equity compensation plans	-	-	-	678	-	-	678
Tax benefits related to non-qualified stock compensation	-	-	-	68	-	-	68
Preferred stock:							
Issuance of Series B Preferred Stock	56,600	-	-	-	-	-	56,600
Redemption of Series A Preferred Stock (23,235 shares)	(23,235)	-	-	-	-	-	(23,235)
Preferred stock dividends	-	-	-	-	(893)	-	(893)
Discount accretion	653	-	-	-	(653)	-	-
Balance, September 30, 2011	$ 56,600	$ 197	$ 946	$ 131,946	$ 64,389	$ 4,384	$ 258,462

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Cash Flows (Unaudited)
(dollars in thousands)

	Nine Months Ended September 30, 2012	2011
Cash Flows From Operating Activities:		
Net Income	$25,091	$17,384
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	12,051	8,218
Depreciation and amortization	2,392	1,855
Gains on sale of loans	(9,867)	(3,872)
Origination of loans held for sale	(981,733)	(432,485)
Proceeds from sale of loans held for sale	997,185	409,021
Net increase in cash surrender value of BOLI	(294)	(301)
(Increase) decrease in deferred income taxes	(1,740)	380
Net (gain) loss on sale of other real estate owned	(26)	299
Net gain on sale of investment securities	(765)	(1,445)
Loss on early extinguishment of debt	529	-
Stock-based compensation expense	2,060	818
Excess tax benefit from stock-based compensation	(87)	(68)
Decrease (increase) in other assets	234	(1,971)
(Increase) decrease in other liabilities	(7,655)	5,992
Net cash provided by operating activities	37,375	3,825
Cash Flows From Investing Activities:		
Increase (decrease) in interest bearing deposits with other banks and short term investments	22	(87,196)
Purchases of available for sale investment securities	(79,314)	(233,491)
Proceeds from maturities of available for sale securities	33,874	87,130
Proceeds from sale/call of available for sale securities	62,888	85,923
Purchases of federal reserve and federal home loan bank stock	(2,763)	(891)
Proceeds from redemption of federal reserve and federal home loan bank stock	974	989
Net increase in loans	(348,405)	(361,479)
Proceeds from sale of other real estate owned	901	5,660
Bank premises and equipment acquired	(4,321)	(3,439)
Net cash used in investing activities	(336,144)	(506,794)
Cash Flows From Financing Activities:		
Increase in deposits	122,671	1,020,551
(Decrease) increase in customer repurchase agreements	(27,994)	50,087
Issuance of Series B Preferred Stock	-	56,600
Redemption of Series A Preferred Stock	-	(22,582)
Increase in other short-term borrowings	10,000	-
Decrease in long-term borrowings	(10,000)	-
Payment of dividends on preferred stock	(426)	(893)
Issuance of common stock	28,500	-
Proceeds from exercise of stock options	1,225	678
Excess tax benefit from stock-based compensation	87	68
Net cash provided by financing activities	124,063	1,104,509

Net (Decrease) Increase In Cash and Cash Equivalents	(174,706)	601,540
Cash and Cash Equivalents at Beginning of Period	232,411	46,462
Cash and Cash Equivalents at End of Period	$57,705	$648,002
Supplemental Cash Flows Information:		
Interest paid	$11,752	$15,548
Income taxes paid	$11,951	$10,330
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$3,555	$2,060
Transfers from other real estate owned to loans	$-	$3,124

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the "Company"), EagleBank (the "Bank"), Eagle Commercial Ventures, LLC ("ECV"), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The consolidated financial statements of the Company included herein are unaudited. The consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2011 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company's Accounting Policies as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland; Washington, DC; and Arlington and Fairfax Counties in Virginia. The primary financial services offered by the Bank include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration ("SBA"), is typically sold to third party investors in a transaction apart from the loan's origination. The Bank offers its products and services through seventeen branch offices and various electronic capabilities, including remote deposit services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, provides subordinated financing for the acquisition, development and construction of real estate projects. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending – Revenue Recognition below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of Small Business Administration loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations.

The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of September 30, 2012, December 31, 2011, and September 30, 2011. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Other Assets in the Statement of Financial Condition. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in other noninterest income in the Consolidated Statement of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 30 to 90 days under current market conditions. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at a premium at the time the borrower commits to an interest rate with the intent that the buyer has assumed the interest rate risk on the loan. As a result, the Company is not exposed to losses on loans sold nor will it realize gains, related to rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

Investment Securities

The Company has no securities classified as trading, nor are any investment securities classified as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income, a separate component of shareholders' equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the Consolidated Statements of Operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayment assumptions and call optionality if any. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management's intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security.

The entire amount of an impairment loss is recognized in earnings only when (1) the Company intends to sell the debt security, or (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in shareholders' equity as comprehensive income, net of deferred taxes.

Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

Higher Risk Lending – Revenue Recognition

The Company has occasionally made higher risk acquisition, development, and construction ("ADC") loans that entail higher risks than ADC loans made following normal underwriting practices ("higher risk loan transactions"). These higher risk loan transactions are currently made through the Company's subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standards Executive Committee ("AcSEC") guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on certain of these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC's guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Such additional interest is included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2012 and 2011 (although normal interest income was recorded). ECV had four higher risk lending transactions with balances outstanding at September 30, 2012 and December 31, 2011, amounting to $3.7 million and $2.3 million, respectively.

Allowance for Credit Losses

The allowance for credit losses represents an amount which, in management's judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification ("ASC") Topic 450, "Contingencies," or ASC Topic 310, "Receivables." Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board Committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management's evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management's judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank's loan portfolio and allowance for credit losses. Such review may result in recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from five to seven years for furniture, fixtures and equipment, to three to five years for computer software and hardware, and to ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the Consolidated Statements of Operations.

Other Real Estate Owned (OREO)

Assets acquired through loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by recent appraisals. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in economic conditions or review by regulatory examiners.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company's testing of potential goodwill impairment (which is performed annually) at December 31, 2011, resulted in no impairment being recorded.

Customer Repurchase Agreements

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company's Consolidated Statement of Condition, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, "Income Taxes." Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made for either uncertain tax positions nor accompanying potential tax penalties and interest for underpayments of income taxes in the Company's tax reserves. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at either September 30, 2012 or December 31, 2011.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

Earnings per Common Share

Basic net income per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents.

Stock-Based Compensation

In accordance with ASC Topic 718, “Compensation,” the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value (computed at the date of grant) of any outstanding fixed stock option grants and restricted stock awards which vest subsequent to December 31, 2005. Compensation expense on variable stock option grants (i.e. performance based grants) is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 6 for a description of stock-based compensation awards, activity and expense.

New Authoritative Accounting Guidance

In July 2012, the FASB issued ASU No. 2012-02, “Testing Indefinite-Lived Intangible Assets for Impairment.” The provisions of ASU No. 2012-02 permit an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform a quantitative impairment test, as is currently required by GAAP. ASU No. 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. As the Company does not have any indefinite-lived intangible assets, other than goodwill, the adoption of ASU No. 2012-02 is expected to have no impact on the Company’s consolidated financial statements.

2. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2012, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest-bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

3. Investment Securities Available for Sale

Amortized cost and estimated fair value of securities available for sale are summarized as follows:

September 30, 2012 (dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U. S. Government agency securities	$44,718	$1,545	$-	$46,263
Residential mortgage backed securities	168,439	3,240	305	171,374
Municipal bonds	72,755	5,646	30	78,371
Other equity investments	407	-	52	355
	$286,319	$10,431	$387	$296,363

December 31, 2011 (dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U. S. Government agency securities	$102,283	$1,547	$77	$103,753
Residential mortgage backed securities	145,451	2,767	240	147,978
Municipal bonds	57,548	4,227	2	61,773
Other equity investments	404	-	97	307
	$305,686	$8,541		