FIRST FINANCIAL BANKSHARES INC
Form 10-Q
July 31, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2009

Commission file number 0-7674

FIRST FINANCIAL BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

Texas	**75-0944023**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

400 Pine Street, Abilene, Texas 79601
(Address of principal executive offices)
(Zip Code)
(325) 627-7155
(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 þ No o

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 Regulations 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). 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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of July 31, 2009:

Class	Number of Shares Outstanding
Common Stock, $0.01 par value per share	20,816,090

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

The consolidated balance sheets of First Financial Bankshares, Inc. (the Company) at June 30, 2009 and 2008 and December 31, 2008, the consolidated statements of earnings and comprehensive earnings for the three and six months ended June 30, 2009 and 2008, and changes in shareholders equity and cash flows for the six months ended June 30, 2009 and 2008, follow on pages 4 through 8.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2009	June 30, 2008	December 31, 2008
	(Unaudited)	(Unaudited)	
ASSETS			
CASH AND DUE FROM BANKS	$ 102,339,248	$ 151,741,843	$ 137,569,957
FEDERAL FUNDS SOLD	26,375,000	107,920,000	27,660,000
INTEREST-BEARING DEPOSITS IN BANKS	17,252,374	4,478,115	3,658,037
Total cash and cash equivalents	145,966,622	264,139,958	168,887,994
TRADING SECURITIES, at fair value	31,188,674	30,794,378	55,990,882
SECURITIES HELD-TO-MATURITY (fair value of $19,746,289, $24,942,002 and $24,072,925 at June 30, 2009 and 2008 and December 31, 2008, respectively)	19,277,615	24,222,291	23,493,088
SECURITIES AVAILABLE-FOR-SALE, at fair value	1,250,784,162	1,098,885,011	1,238,921,868
LOANS			
Held for investment	1,462,884,525	1,505,004,840	1,511,420,878
Held for sale	16,237,278	7,537,241	54,721,837
	1,479,121,803	1,512,542,081	1,566,142,715
Less: Allowance for loan losses	(23,246,778)	(18,676,915)	(21,528,860)
Net loans	1,455,875,025	1,493,865,166	1,544,613,855
BANK PREMISES AND EQUIPMENT, net	63,806,862	63,513,569	65,675,138
INTANGIBLE ASSETS	63,564,937	64,592,409	64,002,968
OTHER ASSETS	47,071,492	44,652,379	50,798,861
Total assets	$ 3,077,535,389	$ 3,084,665,161	$ 3,212,384,654
LIABILITIES AND SHAREHOLDERS EQUITY			
NONINTEREST-BEARING DEPOSITS	$ 741,242,165	$ 807,681,419	$ 797,077,004
INTEREST-BEARING DEPOSITS	1,731,273,077	1,760,940,039	1,785,676,148
Total deposits	2,472,515,242	2,568,621,458	2,582,753,152

DIVIDENDS PAYABLE	7,076,967	7,069,362	7,071,342
SHORT-TERM BORROWINGS	176,672,781	149,894,715	235,598,268
OTHER LIABILITIES	32,411,300	15,169,002	18,179,664
Total liabilities	2,688,676,290	2,740,754,537	2,843,602,426
COMMITMENTS AND CONTINGENCIES			
SHAREHOLDERS EQUITY			
Common stock $0.01 par value, authorized 40,000,000 shares; 20,814,760, 20,792,309, and 20,799,198 shares issued at June 30, 2009 and 2008 and December 31, 2008, respectively	208,148	207,923	207,992
Capital surplus	268,608,275	267,761,861	268,087,449
Retained earnings	102,756,184	77,377,884	89,637,172
Treasury stock (shares at cost: 160,438, 158,949, and 158,811 at June 30, 2009 and 2008, and December 31, 2008, respectively)	(3,671,412)	(3,344,178)	(3,500,436)
Deferred compensation	3,671,412	3,344,178	3,500,436
Accumulated other comprehensive earnings (loss)	17,286,492	(1,437,044)	10,849,615
Total shareholders equity	388,859,099	343,910,624	368,782,228
Total liabilities and shareholders equity	$ 3,077,535,389	$ 3,084,665,161	$ 3,212,384,654

See notes to consolidated financial statements.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
INTEREST INCOME:				
Interest and fees on loans	$ 22,689,634	$ 25,664,182	$ 45,743,500	$ 54,041,270
Interest on investment securities:				
Taxable	9,151,393	9,270,122	18,806,422	18,388,507
Exempt from federal income tax	4,498,998	3,405,905	8,626,861	6,786,927
Interest on trading securities	57,419	104,759	140,312	104,759
Interest on federal funds sold and interest-bearing deposits in banks	70,678	506,064	113,164	1,375,824
Total interest income	36,468,122	38,951,032	73,430,259	80,697,287
INTEREST EXPENSE:				
Interest on deposits	4,154,717	8,490,926	8,931,676	19,578,964
Other	192,647	439,835	454,392	1,268,467
Total interest expense	4,347,364	8,930,761	9,386,068	20,847,431
Net interest income	32,120,758	30,020,271	64,044,191	59,849,856
PROVISION FOR LOAN LOSSES	1,588,003	1,441,000	3,348,506	2,509,251
Net interest income after provision for loan losses	30,532,755	28,579,271	60,695,685	57,340,605
NONINTEREST INCOME:				
Trust fees	2,125,783	2,359,307	4,242,289	4,728,358
Service charges on deposit accounts	5,420,816	5,671,396	10,561,888	11,196,383
ATM and credit card fees	2,426,534	2,263,860	4,635,534	4,295,060
Real estate mortgage operations	858,434	764,610	1,445,944	1,369,233
Net gain on securities transactions	498,261	166,414	747,352	559,057
Net gain on sale of student loans		1,431,515	616,477	1,714,595
Net gain (loss) on sale of foreclosed assets	99,467	(15,022)	(59,262)	89,226
Other	690,403	813,317	1,465,590	1,815,624
Total noninterest income	12,119,698	13,455,397	23,655,812	25,767,536
NONINTEREST EXPENSE:				
Salaries and employee benefits	12,241,044	12,545,177	24,233,415	25,093,093
Net occupancy expense	1,566,783	1,651,539	3,186,521	3,242,724
Equipment expense	1,967,774	1,865,328	3,907,802	3,712,107
Printing, stationery and supplies	464,893	440,667	897,512	950,785

FDIC insurance premiums	2,305,307	143,171	3,256,288	276,167
Amortization of intangible assets	215,830	304,194	438,031	614,760
Other expenses	5,595,962	6,058,802	11,385,685	11,780,850
Total noninterest expense	24,357,593	23,008,878	47,305,254	45,670,486
EARNINGS BEFORE INCOME TAXES	18,294,860	19,025,790	37,046,243	37,437,655
INCOME TAX EXPENSE	4,728,865	5,423,608	9,776,677	10,673,840
NET EARNINGS	$ 13,565,995	$ 13,602,182	$ 27,269,566	$ 26,763,815
EARNINGS PER SHARE, BASIC	$ 0.65	$ 0.65	$ 1.31	$ 1.29
EARNINGS PER SHARE, ASSUMING DILUTION	$ 0.65	$ 0.65	$ 1.31	$ 1.29
DIVIDENDS PER SHARE	$ 0.34	$ 0.34	$ 0.68	$ 0.66

See notes to consolidated financial statements.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
NET EARNINGS	$ 13,565,995	$ 13,602,182	$ 27,269,566	$ 26,763,815
Change in unrealized gain (loss) on investment securities available-for-sale, before income taxes	1,257,417	(22,404,774)	10,650,240	(7,524,909)
Reclassification adjustment for realized gains on investment securities included in net earnings, before income tax	(498,261)	(166,414)	(747,352)	(559,057)
Total other items of comprehensive earnings (loss)	759,156	(22,571,188)	9,902,888	(8,083,966)
Income tax benefit (expense) related to other items of comprehensive earnings (loss)	(265,705)	7,899,916	(3,466,011)	2,829,388
COMPREHENSIVE EARNINGS	$ 14,059,446	$ (1,069,090)	$ 33,706,443	$ 21,509,237

See notes to consolidated financial statements.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

	Common Stock		Capital	Retained	Treasury Stock		Deferred	Accumulated Other Comprehensive	Total Sharehol
	Shares	Amount	Surplus	Earnings	Shares	Amounts	Compensation	Earnings	Equit
ces at nber 31,	20,766,848	$ 207,669	$ 267,136,338	$ 64,333,921	(155,415)	$ (3,170,304)	$ 3,170,304	$ 3,817,534	$ 335,495
arnings dited)				26,763,815					26,763
issuances dited)	25,461	254	482,642						482
dividends ed, $0.66 are dited)				(13,719,852)					(13,719
ge in ized gain in ment ties ble-for-sale, related e taxes dited)								(5,254,578)	(5,254
ional tax t related to ors deferred ensation plan dited)			30,000						30
s purchased nection with ors deferred ensation net dited)					(3,534)	(173,874)	173,874		
option se dited)			112,881						112

ces at 30, 2008 dited)	20,792,309	$ 207,923	$ 267,761,861	$ 77,377,884	(158,949)	$ (3,344,178)	$ 3,344,178	$ (1,437,044)	$ 343,910
ces at nber 31,	20,799,198	$ 207,992	$ 268,087,449	$ 89,637,172	(158,811)	$ (3,500,436)	$ 3,500,436	$ 10,849,615	$ 368,782
arnings dited)				27,269,566					27,269
issuances dited)	15,562	156	354,497						354
dividends ed, $0.68 are dited)				(14,150,554)					(14,150
ge in ized gain in ment ties ble- for-sale, related e taxes dited)								6,436,877	6,436
ional tax t related to ors deferred ensation plan dited)			30,000						30
s purchased nection with ors deferred ensation net dited)					(1,627)	(170,976)	170,976		
option se dited)			136,329						136
ces at 30, 2009 dited)	20,814,760	$ 208,148	$ 268,608,275	$ 102,756,184	(160,438)	$ (3,671,412)	$ 3,617,412	$ 17,286,492	$ 388,859

See notes to consolidated financial statements.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$ 27,269,566	$ 26,763,815
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	3,897,856	3,955,115
Provision for loan losses	3,348,506	2,509,251
Securities premium amortization (discount accretion), net	525,905	185,875
Gain on sale of assets, net	(1,403,061)	(2,519,152)
Deferred federal income tax benefit	(213,135)	(667,449)
Trading security activity, net	24,802,208	(30,794,378)
Loans originated for resale	(111,948,927)	(89,824,825)
Proceeds from sales of loans held for resale	150,971,960	119,579,056
Change in other assets	4,142,045	3,047,163
Change in other liabilities	1,997,681	2,972,575
Total adjustments	76,121,038	8,443,231
Net cash provided by operating activities	103,390,604	35,207,046
CASH FLOWS FROM INVESTING ACTIVITIES:		
Activity in available-for-sale securities:		
Sales	35,359,157	69,625,614
Maturities	111,156,835	145,885,473
Purchases	(139,109,541)	(227,645,540)
Activity in held-to-maturity securities maturities	4,217,076	2,193,300
Net decrease (increase) in loans	44,357,760	(14,646,267)
Purchases of bank premises and equipment and computer software	(1,128,090)	(5,756,257)
Proceeds from sale of other assets	1,788,500	1,034,669
Net cash provided by (used in) investing activities	56,641,697	(29,309,008)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in noninterest-bearing deposits	(55,834,839)	68,500,439
Net decrease in interest-bearing deposits	(54,403,071)	(45,961,999)
Net decrease in short-term borrowings	(58,925,487)	(16,371,711)
Common stock transactions:		
Proceeds from stock issuances	354,653	482,896
Dividends paid	(14,144,929)	(13,296,081)
Net cash used in financing activities	(182,953,673)	(6,646,456)

NET DECREASE IN CASH AND CASH EQUIVALENTS	(22,921,372)	(748,418)
CASH AND CASH EQUIVALENTS, beginning of period	168,887,994	264,888,376
CASH AND CASH EQUIVALENTS, end of period	$ 145,966,622	$ 264,139,958
SUPPLEMENTAL INFORMATION AND NONCASH TRANSACTIONS		
Interest paid	$ 10,016,125	$ 19,408,096
Federal income tax paid	10,305,982	11,535,911
Transfer of loans to foreclosed assets	2,626,008	790,287
Investment securities purchased but not settled	9,926,301	4,186,873

See notes to consolidated financial statements.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

The consolidated financial statements include the accounts of the Company, a Texas corporation and a financial holding company registered under the Bank Holding Company Act of 1956, or BHCA, and its wholly-owned subsidiaries: First Financial Bankshares of Delaware, Inc.; First Financial Investments of Delaware, Inc.; First Financial Bank, National Association, Abilene, Texas; First Financial Bank, Hereford, Texas; First Financial Bank, National Association, Sweetwater, Texas; First Financial Bank, National Association, Eastland, Texas; First Financial Bank, National Association, Cleburne, Texas; First Financial Bank, National Association, Stephenville, Texas; San Angelo National Bank, San Angelo, Texas; First Financial Bank, National Association, Weatherford, Texas; First Financial Bank, National Association, Southlake, Texas; First Financial Bank, National Association, Mineral Wells, Texas; First Technology Services, Inc.; First Financial Trust & Asset Management Company, National Association; First Financial Investments, Inc.; and First Financial Insurance Agency, Inc.

Through our subsidiary banks, we conduct a full-service commercial banking business. Our service centers are located primarily in North Central and West Texas. Considering the braches and locations of all our bank subsidiaries, as of June 30, 2009, we had 48 financial centers across Texas, with ten locations in Abilene, two locations in Cleburne, three locations in Stephenville, three locations in Granbury, two locations in San Angelo, three locations in Weatherford, and one location each in Mineral Wells, Hereford, Sweetwater, Eastland, Ranger, Rising Star, Southlake, Aledo, Willow Park, Brock, Alvarado, Burleson, Keller, Trophy Club, Boyd, Bridgeport, Decatur, Roby, Trent, Merkel, Clyde, Moran, Albany, Midlothian and Glen Rose. Our trust subsidiary has six locations in Abilene, San Angelo, Stephenville, Sweetwater, Fort Worth and Odessa, all in Texas.

In the opinion of management, the unaudited consolidated financial statements reflect all adjustments necessary for a fair presentation of the Company s financial position and unaudited results of operations. All adjustments were of a normal recurring nature. However, the results of operations for the three and six months ended June 30, 2009, are not necessarily indicative of the results to be expected for the year ending December 31, 2009, due to seasonality, changes in economic conditions and credit quality, interest rate fluctuations, regulatory and legislative changes and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) have been condensed or omitted under SEC rules and regulations. Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 presentation. The Company evaluated subsequent events for potential recognition and/or disclosure through July 31, 2009, the date the consolidated financial statements were issued.

Goodwill and other intangible assets are evaluated annually for impairment as of the end of the second quarter. No such impairment was noted as of June 30, 2009.

Note 2 Earnings Per Share

Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding during the periods. In computing diluted earnings per common share for the three and six months ended June 30, 2009 and 2008, the Company assumes that all dilutive outstanding options to purchase common stock have been exercised at the beginning of the period (or the time of issuance, if later). The dilutive effect of the outstanding options is reflected by application of the treasury stock method, whereby the proceeds from the exercised options are assumed to be used to purchase common stock at the average market price during the respective periods. The weighted average common shares outstanding used in computing basic earnings per common share for the three months ended June 30, 2009 and 2008, were 20,809,061 and 20,786,902, respectively. The weighted average common shares outstanding used in computing basic earnings per share for the six months ended June 20, 2009 and 2008 were 20,805,392 and 20,780,421, respectively. The weighted average common shares outstanding used in computing fully diluted earnings per common share for the three months ended June 30, 2009 and 2008, were 20,830,965 and 20,833,048, respectively. The weighted average common shares outstanding used in computing fully diluted earnings per common share for the six months ended June 30, 2009 and 2008, were 20,821,782 and 20,816,219, respectively.

Note 3 Available-for-Sale and Held-to-Maturity Securities

A summary of available-for-sale and held-to-maturity securities is as follows:

	June 30, 2009			
	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Securities held-to-maturity:				
Obligations of state and political subdivisions	$ 18,552	$ 487	$ (34)	$ 19,005
Mortgage-backed securities	726	16	(1)	741
Total debt securities held-to-maturity	$ 19,278	$ 503	$ (35)	$ 19,746
Securities available-for-sale:				
Obligations of U.S. government sponsored-enterprises and agencies	$ 258,408	$ 11,982	$	$ 270,390
Obligations of state and political subdivisions	443,777	8,191	(2,714)	449,254
Corporate bonds	78,216	3,906	(3)	82,119
Mortgage-backed securities	429,230	14,204	(176)	443,258
Other securities	5,550	213		5,763
Total securities available-for-sale	$ 1,215,181	$ 38,496	$ (2,893)	$ 1,250,784

	June 30, 2008			
	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Securities held-to-maturity:				
Obligations of state and political subdivisions	$ 23,082	$ 720	$ (13)	$ 23,789
Mortgage-backed securities	1,140	16	(3)	1,153
Total debt securities held-to-maturity	$ 24,222	$ 736	$ (16)	$ 24,942
Securities available-for-sale:				
U.S. Treasury securities and obligations of U.S. government sponsored-enterprises and agencies	$ 302,781	$ 3,456	$ (1,959)	$ 304,278
Obligations of state and political subdivisions	322,021	3,356	(2,741)	322,636

Corporate bonds	43,143		436		(70)	43,509
Mortgage-backed securities	422,893		3,393		(3,610)	422,676
Other securities	5,699		87			5,786
Total securities available-for-sale	$ 1,096,537	$	10,728	$	(8,380)	$ 1,098,885

During the quarter ended June 30, 2009 and 2008, sales of investment securities that were classified as available-for-sale totaled $30.0 million and $15.6 million, respectively. Gross realized gains from 2009 and 2008 securities sales totaled $498 thousand and $166 thousand, respectively. There were no losses on securities sales during these periods. During the six-months ended June 30, 2009 and 2008, sales of investment securities that were classified as available-for-sale totaled $35.4 million and $69.6 million, respectively. Gross realized gains from 2009 and 2008 securities sales were $747 thousand and $559 thousand, respectively. There were no losses on securities sales during these periods. The specific identification method was used to determine cost on computing the realized gains.

The following tables disclose, as of June 30, 2009 and 2008, our available-for-sale and held-to- maturity securities that have been in a continuous unrealized-loss position for less than 12 months and those that have been in a continuous unrealized-loss position for 12 or more months (in thousands):

	Less than 12 Months		12 Months or Longer		Total	
June 30, 2009	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of state and political subdivisions	$ 107,190	$ 2,563	$ 2,676	$ 185	$ 109,866	$ 2,748
Mortgage-backed securities	30,809	176	43	1	30,852	177
Corporate and other securities	4,994	3			4,994	3
Total	$ 142,993	$ 2,742	$ 2,719	$ 186	$ 145,712	$ 2,928

	Less than 12 Months		12 Months or Longer		Total	
June 30, 2008	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of U.S. government sponsored-enterprises and agencies	$ 118,167	$ 1,959	$	$	$ 118,167	$ 1,959
Obligations of state and political subdivisions	135,209	2,720	898	34	136,107	2,754
Mortgage-backed securities	145,248	2,076	41,022	1,537	186,270	3,613
Corporate and other securities	9,097	70			9,097	70
Total	$ 407,721	$ 6,825	$ 41,920	$ 1,571	$ 449,641	$ 8,396

The number of investment positions in this unrealized loss position totaled 299 at June 30, 2009. We do not believe these unrealized losses are other than temporary as (1) we do not have the intent to sell our securities prior to recovery and (2) it is more likely than not that we will not have to sell our securities prior to recovery. The unrealized losses noted are interest rate related due to the level of interest rates at June 30, 2009. We have reviewed the ratings of the issuers and have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities. Our mortgage related securities are backed by GNMA, FNMA and FHLMC or are collateralized by securities backed by these agencies.

Note 4 Loans And Allowance for Loan Losses
Major classifications of loans are as follows (dollars in thousands):

	June 30, 2009	June 30, 2008	December 31, 2008
Commercial, financial and agricultural	$ 464,377	$ 451,067	$ 485,707
Real estate construction	104,168	181,685	158,000
Real estate mortgage	715,211	637,504	678,788
Consumer	195,366	242,286	243,648
Total Loans	$ 1,479,122	$ 1,512,542	$ 1,566,143

Included in real estate-mortgage and consumer loans above are $4.1 million and $12.1 million, respectively, in loans held for sale at June 30, 2009, $3.7 million and $3.8 million, respectively, at June 30, 2008 and $2.9 million and $51.8 million, respectively, in loans held for sale at December 31, 2008, in which the carrying amounts approximate fair value.

The Company s recorded investment in impaired loans and the related valuation allowance are as follows (dollars in thousands):

June 30, 2009		June 30, 2008		December 31, 2008	
Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
$ 10,242	$ 2,495	$ 8,963	$ 1,113	$ 9,893	$ 2,040

The allowance for loan losses as of June 30, 2009 and 2008 and December 31, 2008, is presented below. Management has evaluated the adequacy of the allowance for loan losses by estimating the probable losses in various categories of the loan portfolio which are identified below:

	June 30, 2009	June 30, 2008	December 31, 2008
Allowance for loan losses provided for:			
Loans specifically evaluated as impaired	$ 2,495,366	$ 1,113,473	$ 2,040,323
Remaining portfolio	20,751,412	17,563,442	19,488,537
Total allowance for loan losses	$ 23,246,778	$ 18,676,915	$ 21,528,860

Changes in the allowance for loan losses are summarized as follows:

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Balance at beginning of period	$ 22,651,726	$ 18,377,340	$ 21,528,860	$ 17,461,514
Add:				
Provision for loan losses	1,588,003	1,441,000	3,348,506	2,509,251
Loan recoveries	231,752	233,107	487,281	368,346

Deduct:				
Loan charge-offs	(1,224,703)	(1,374,532)	(2,117,869)	(1,662,196)
Balance at end of period	$ 23,246,778	$ 18,676,915	$ 23,246,778	$ 18,676,915

Nonaccrual, loans still accruing and past due 90 days or more, restructured loans and foreclosed assets are as follows:

	June 30, 2009	June 30, 2008	December 31, 2008
Nonaccrual loans	$ 10,242	$ 8,963	$ 9,893
Loans still accruing and past due 90 days or more	72		36
Restructured loans			
Foreclosed assets	3,755	1,792	2,602
Total	$ 14,069	$ 10,755	$ 12,531
As a % of loans and foreclosed assets	0.95%	0.71%	0.80%
As a % of total assets	0.46	0.35	0.39

Note 5 Stock Based Compensation

The Company grants incentive stock options for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of grant to employees. In May 2009, the Company granted 101,600 incentive stock options with an exercise price of $50.33 per share. The fair value of the options granted was estimated using the Black-Scholes options pricing model with the following weighted-average assumptions: risk-free interest rate of 3.24%; expected dividend yield of 2.66%; expected life of 5.79 years; and expected volatility of 41.64%.

The Company recorded stock option expense totaling approximately $71 thousand and $56 thousand, respectively, for the three month periods ended June 30, 2009 and 2008. The Company recorded stock option expense totaling $136 thousand and $113 thousand, respectively, for the six month periods ended June 30, 2009 and 2008.

The additional disclosure requirements of Statement of Financial Accounting Standard (SFAS) No. 123R, Share-Based Payment have been omitted due to immateriality.

Note 6 Pension Plan

The Company s defined benefit pension plan was frozen effective January 1, 2004, whereby no additional years of service will accrue to participants, unless the pension plan is reinstated at a future date. The pension plan covered substantially all of the Company s employees. The benefits for each employee were based on years of service and a percentage of the employee s qualifying compensation during the final years of employment. The Company s funding policy was and is to contribute annually the amount necessary to satisfy the Internal Revenue Service s funding standards. Contributions to the pension plan, prior to freezing the plan, were intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. As a result of the Pension Protection Act of 2006 (the Protection Act), the Company will be required to contribute amounts in future years to fund any shortfalls. The Company evaluated the provisions of the Protection Act as well as the Internal Revenue Service s funding standards to develop a preliminary plan for funding in future years. The Company made a contribution totaling $1.4 million in April 2009 and $800 thousand in 2008 and continues to evaluate future funding amounts.

Net periodic benefit costs totaling $80 thousand and $79 thousand were recorded, respectively, for the three months ended June 30, 2009 and 2008. Net periodic benefit costs totaling $160 thousand and $157 thousand were recorded, respectively, in the six months ended June 30, 2009 and 2008.

Note 7 Recently Issued Pronouncements

Effective January 1, 2009, SFAS No. 141R, Business Combinations (Revised 2007) replaced SFAS 141, Business Combinations, and applies to all transactions and other events in which one entity obtains control over one or more other businesses. FASB Staff Position No. 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies was issued in April 2009 to amend and clarify SFAS 141R. These pronouncements require an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. As a result, an acquired bank s allowance for loan losses will not be brought over to the Company s allowance for loan losses but rather be recorded at fair value at date of acquisition. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition if the acquisition fair value of that asset or liability can be determined during the measurement period. If the acquisition date fair value of an asset acquired or a liability assumed in a business combination that arises from a contingency cannot be determined during the measurement period, an asset or a liability shall be recognized at the acquisition date if both the information available for the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date and the amount of the asset or liability can be reasonably estimated. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. These pronouncements also require acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. SFAS 141R is expected to have an impact on the Company s accounting for business combinations closing after January 1, 2009.

In March 2009, the FASB issued three FASB Staff Positions (FSP):

No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments This FSP amends the other-than-temporary impairment guidance under U.S. GAAP for debt securities to make the guidance more operational and improve the presentation and disclosure in the financial statement. The FSP specifies that if a company does not have the intent to sell a debt security prior to recovery and it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporary impaired unless there is a credit loss. The credit loss component of an other-than-temporary impaired debt security must be determined based on the company s best estimate of cash flows expected to be collected.

No. FAS 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 This FSP provides additional guidance for estimating fair value in accordance with SFAS No. 157, Fair Value Measurements, when the volume and level of activity for the asset and liability have significantly decreased and for identifying circumstances that indicate a transaction is not orderly. SFAS 157 does not prescribe a methodology for making significant adjustments to transactions or quoted prices when estimating fair value in these situations but this FSP states that a change in valuation technique or the use of multiple valuation techniques may be appropriate.

No. 107-1 and APB 28-1, Interim Disclosure about Fair Value of Financial Instruments This FSP requires companies to provide the same fair value of financial instruments disclosures presently required on an annual basis on a quarterly interim basis.

These three FSP s were effective for the period ended June 30, 2009 and did not have a significant impact on the Company s financial position, results of operations or cash flows other than additional disclosures.

In May 2009, SFAS No. 165, Subsequent Events was issued which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS 65 sets forth (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This pronouncement was effective for the period ended June 30, 2009 and did not have a significant impact on the Company s financial statements.

In June 2009, SFAS No. 166, Accounting for Transfers of Financial Assets an Amendment of FASB Statement No. 140 was issued to improve the information a reporting entity provides in its financial statements about a transfer of financial assets, including the effect of a transfer on an entity s financial position, financial performance and cash flows and the transferor s continuing involvement in the transferred assets. SFAS 166 eliminates the concept of a qualifying special-purpose entity and changes the guidance for evaluation for consolidation. This pronouncement is effective January 1, 2010 and is not expected to have a significant impact on the Company s financial position, results of operations or cash flows.

In June 2009, SFAS No. 167, Amendments to FASB Interpretation No. 46(R) was issued to amend previous guidance to replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and (i) the obligation to absorb losses of the entity or (ii) the right to receive benefits from the entity. The pronouncement is effective January 1, 2010 and is not expected to have a significant impact on the Company s financial position, results of operations or cash flows.

In June 2009, SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Principles, a Replacement of FASB Statement No. 162 was issued and established the FASB Accounting Standards Codification (Codification) as the source of authoritative U. S. generally accepted accounting principles recognized by the FASB to be applied by nongovernmental entities. Rules and interpretative releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All non-grandfathered, non-SEC accounting literature not included in the Codification will become nonauthoritative. The pronouncement and the Codification will be effective in the period ending September 30, 2009 and is not expected to have a significant impact on the Company s financial statements.

Note 8 Fair Value Disclosures

SFAS No. 157, Fair Value Measurements, and as clarified with several FSP s, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (for example, interest rates, volatilities, prepayment speeds, loss severities, credit risks and default rates) or inputs that are derived principally from or corroborated by observable market data by correlation or other means. Level 2 investments consist primarily of obligations of U.S. government sponsored enterprises and agencies, obligations of state and municipal subdivisions, corporate bonds and mortgage backed securities.

Level 3 Inputs Significant unobservable inputs that reflect an entity s own assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities classified as available for sale and trading are reported at fair value utilizing Level 1 and Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the United States Treasury (the Treasury) yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the bond s terms and conditions, among other things.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (dollars in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Investment securities available for sale	$64,166	$1,186,618	$	$1,250,784
Trading investment securities	31,189			31,189

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis include the following at June 30, 2009:

Impaired Loans Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 input based on the discounting of the collateral. At June 30, 2009, impaired loans with a carrying value of $10.2 million were reduced by specific valuation allowance totaling $2.5 million resulting in a net fair value of $7.7 million, based on Level 3 inputs.

Loans Held for Sale Loans held for sale are reported at the lower of cost or fair value. In determining whether the fair value of loans held for sale is less than cost when quoted market prices are not available, the Company considers investor commitments/contracts. These loans are considered Level 2 of the fair value hierarchy. At June 30, 2009, the Company s mortgage loans held for sale and student loans held for sale were recorded at cost as fair value exceeded cost.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring and non-recurring basis include other real estate owned, goodwill and other intangible assets and other non-financial long-lived assets. Such amounts were not significant to the Company at June 30, 2009.

Under SFAS 107, the Company is required to disclose the estimated fair value of their financial instrument assets and liabilities including those subject to the requirements of SFAS 157. For the Company, as for most financial institutions, substantially all of its assets and liabilities are considered financial instruments, as defined. Many of the Company s financial instruments, however, lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction.

The estimated fair value amounts of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

In addition, reasonable comparability between financial institutions may not be likely due to the wide range of permitted valuation techniques and numerous estimates that must be made given the absence of active secondary markets for many of the financial instruments. This lack of uniform valuation methodologies also introduces a greater degree of subjectivity to these estimated fair values.

Financial instruments with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities. Financial instruments assets with variable rates and financial instrument liabilities with no stated maturities have an estimated fair value equal to both the amount payable on demand and the carrying value.

The carrying value and the estimated fair value of the Company s contractual off-balance-sheet unfunded lines of credit, loan commitments and letters of credit, which are generally priced at market at the time of funding, are not material.

The estimated fair values and carrying values of all financial instruments covered by SFAS 157 and SFAS 107 at June 30, 2009 were as follows (in thousands):

	Carrying Value	Estimated Fair Value
Cash and due from banks	$ 102,339	$ 102,339
Federal funds sold	26,375	26,375
Interest-bearing deposits in banks	17,252	17,252
Trading securities	31,189	31,189
Held to maturity securities	19,278	19,746
Available for sale securities	1,250,784	1,250,784
Net loans	1,455,875	1,446,625
Accrued interest receivable	19,619	19,619
Deposits with stated maturities	709,066	712,537
Deposits with no stated maturities	1,763,449	1,763,449
Short term borrowings	176,673	176,673
Accrued interest payable	1,651	1,651

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

Forward-Looking Statements

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this Form 10-Q, words such as anticipate, believe, estimate, expect, intend, predict, project, and similar expressions, as they relate to us o management, identify forward-looking statements. These forward-looking statements are based on information currently available to our management. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including, but not limited to, those listed in Item 1A- Risk Factors in our Annual Report on Form 10-K and the following:

General economic conditions, including our local and national real estate markets and employment trends;

Volatility and disruption in national and international financial markets;

Legislative, tax and regulatory actions and reforms;

Political instability;

The ability of the Federal government to deal with the national economic slowdown and the terms of any stimulus package enacted by Congress;

Competition from other financial institutions and financial holding companies;

The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Governors of the Federal Reserve System;

Changes in the demand for loans;

Fluctuations in the value of collateral securing our loan portfolio and in the level of the allowance for loan losses;

Soundness of other financial institutions with which we have transactions;

Inflation, interest rate, market and monetary fluctuations;

Changes in consumer spending, borrowing and savings habits;

Legislative changes and other developments in student loan originations and sales;

Anticipated increases in FDIC deposit insurance assessments;

Our ability to attract deposits;

Consequences of continued bank mergers and acquisitions in our market area, resulting in fewer but much larger and stronger competitors;

Expansion of operations, including branch openings, new product offerings and expansion into new markets;

Acquisitions and integration of acquired businesses; and

Acts of God or of war or terrorism.

Such statements reflect the current views of our management with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this paragraph. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

<u>Introduction</u>

As a multi-bank financial holding company, we generate most of our revenue from interest on loans and investments, trust fees, and service charges. Our primary source of funding for our loans and investments are deposits held by our subsidiary banks. Our largest expenses are interest on these deposits and salaries and related employee benefits. We usually measure our performance by calculating our return on average assets, return on average equity, our regulatory leverage and risk based capital ratios, and our efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax equivalent basis and noninterest income.

The following discussion of operations and financial condition should be read in conjunction with the financial statements and accompanying footnotes included in Item 1 of this Form 10-Q as well as those included in the Company s 2008 Annual Report on Form 10-K.

Critical Accounting Policies

We prepare consolidated financial statements based on the selection of certain accounting policies, generally accepted accounting principles and customary practices in the banking industry. These policies, in certain areas, require us to make significant estimates and assumptions.

We deem a policy critical if (1) the accounting estimate required us to make assumptions about matters that are highly uncertain at the time we make the accounting estimate; and (2) different estimates that reasonably could have been used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the financial statements.

The following discussion addresses (1) our allowance for loan losses and its provision for loan losses and (2) our valuation of securities, which we deem to be our most critical accounting policies. We have other significant accounting policies and continue to evaluate the materiality of their impact on our consolidated financial statements, but we believe these other policies either do not generally require us to make estimates and judgments that are difficult or subjective, or it is less likely they would have a material impact on our reported results for a given period.

Allowance for Loan Losses:

The allowance for loan losses is an amount we believe will be adequate to absorb inherent estimated losses on existing loans in which full collectibility is unlikely based upon our review and evaluation of the loan portfolio. The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries).

Our methodology is based on guidance provide in SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues and includes allowance allocations calculated in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan, as amended by SFAS No. 118, and allowance allocations determined in accordance with SFAS No. 5, Accounting for Contingencies. We also follow the guidance of the Interagency Policy Statement on the Allowance for Loan and Lease Losses, issued jointly by the OCC, the Federal Reserve Board, the FDIC, the National Credit Union Administration and the Office of Thrift Supervision. We have developed a loan review methodology that includes allowances assigned to certain classified loans, allowances assigned based upon estimated loss factors and qualitative reserves. The level of the allowance reflects our periodic evaluation of general economic conditions, the financial condition of our borrowers, the value and liquidity of collateral, delinquencies, prior loan loss experience, and the results of periodic reviews of the portfolio by our independent loan review department and regulatory examiners.

Our allowance for loan losses is comprised of three elements: (i) specific reserves determined in accordance with SFAS 114 based on probable losses on specific classified loans; (ii) general reserves determined in accordance with SFAS 5 that consider historical loss rates; and (iii) a qualitative reserve determined in accordance with SFAS 5 based upon general economic conditions and other qualitative risk factors both internal and external to the Company. We regularly evaluate our allowance for loan losses to maintain an adequate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of specific reserves include the credit-worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All classified loans are specifically reviewed and a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the loan portfolio less cash secured loans, government guaranteed loans and classified loans is multiplied by the Company s historical loss rates. The qualitative reserves are determined by evaluating such things as current economic conditions and trends, changes in lending staff, policies or procedures, changes in credit concentrations, changes in the trends and severity of problem loans and changes in trends in volume and terms of loans.

Although we believe we use the best information available to make loan loss allowance determinations, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making our initial determinations. A downturn in the economy and employment could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in income. Additionally, as an integral part of their examination process, bank regulatory agencies periodically review our allowance for loan losses. The bank regulatory agencies could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, the borrower s financial condition is such that collection of principal and interest is doubtful.

Our policy requires measurement of the allowance for an impaired collateral dependent loan based on the fair value of the collateral. Other loan impairments are measured based on the present value of expected future cash flows or the loan s observable market price.

Valuation of Securities:

The Company records its available-for-sale and trading securities portfolio at fair value.

Fair values of these securities are determined based on methodologies in accordance with SFAS 157, and as clarified with several FSP s. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, credit ratings and yield curves. Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security.

When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exists. Available-for-sale and held-to-maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (i) whether we have the intent to sell our securities prior to recovery and/or maturity and (ii) whether it is more likely than not that we will have to sell our securities prior to recovery and/or maturity. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company s results of operations and financial condition.

Results of Operations

Performance Summary. Net earnings for the second quarter of 2009 were $13.6 million, a decrease of $36 thousand, or 0.3% from the same period in 2008. Net earnings for the second quarter of 2009 compared to the second quarter of 2008 were negatively impacted by a decrease in noninterest income, including the gain on sale of student loans in the second quarter of 2008 as compared to the second quarter of 2009 and the increase of $2.2 million in FDIC insurance premiums, including special assessment (see below). The negative impact of these items was substantially offset by an increase in net interest income and decreases in certain other categories of noninterest expense.

On a basic net earnings per share basis, net earnings were $0.65 for the second quarter of 2009, unchanged from the same quarter of 2008. The return on average assets was 1.77% for the second quarter of 2009, as compared to 1.81% for the same quarter of 2008. The return on average equity was 13.98% for the second quarter of 2009 as compared to 15.55% for the same quarter of 2008.

Net earnings for the six-month period ended June 30, 2009 were $27.3 million, an increase of $506 thousand, or 1.9%, compared to net earnings for the six-month period ended June 30, 2008 of $26.8 million. The increase in net earnings for 2009 over 2008 was primarily attributable to an increase in net interest income which offset the impact of the increase in FDIC insurance premiums and the reduction in the gain on the sale of student loans.

On a basic net earnings per share basis, net earnings were $1.31 for the six-months of 2009 as compared to $1.29 for the same period of 2008. The return on average assets was 1.76% for the six-months of 2009, as compared to 1.78% for the same period of 2008. The return on average equity was 14.28% for the six-months of 2009, as compared to 15.48% for the same period of 2008.

Net Interest Income. Net interest income is the difference between interest income on earning assets and interest expense on liabilities incurred to fund those assets. Our earning assets consist primarily of loans and investment securities. Our liabilities to fund those assets consist primarily of noninterest-bearing and interest-bearing deposits. Tax-equivalent net interest income was $34.6 million for the second quarter of 2009, as compared to $31.7 million for the same period last year. The increase in 2009 compared to 2008 was largely attributable to (i) the decrease in the rate paid on interest-bearing liabilities in an amount greater than the decrease in rates earned on interest earning assets and (ii) an increase in the volume of earning assets. Average earning assets increased $73.3 million for the second quarter of 2009 over the same period in 2008. Average taxable and tax exempt securities increased $162.8 million for the second quarter of 2009 over 2008, offsetting a decrease of $38.3 million in average loans. Average interest bearing liabilities decreased $6.4 million for the second quarter of 2009 over the same period in 2008. The yield on earning assets decreased 41 basis points in the second quarter of 2009, whereas the rate paid on interest-bearing liabilities decreased 97 basis points, primarily due to the effects of lower interest rates.

Tax-equivalent net interest income was $68.7 million for the first six-month period of 2009, as compared to $63.1 million for the same period last year. The increase in 2009 compared to 2008 was largely attributable to (i) the decrease in the rate paid on interest-bearing liabilities in an amount greater than the decrease in rates earned on interest earning assets and (ii) an increase in the volume of earning assets. Average earning assets increased $113.0 million for the first six-months of 2009. Average taxable and tax exempt securities increased $181.0 million, offsetting a decrease of $3.4 million in average loans. Average interest bearing liabilities increased $15.6 million for the six-month period of 2009 over 2008. The yield on earning assets decreased 63 basis points in the six-months of 2009, whereas the rate paid on interest-bearing liabilities decreased 119 basis points.

Table 1 allocates the change in tax-equivalent net interest income between the amount of change attributable to volume and to rate.

Table 1 Changes in Interest Income and Interest Expense (in thousands):

	Three Months Ended June 30, 2009 Compared to Three Months Ended June 30, 2008			Six Months Ended June 30, 2009 Compared to Six Months Ended June 30, 2008		
	Change Attributable to			Change Attributable to		
	Volume	Rate	Total Change	Volume	Rate	Total Change
Short-term investments	$ (234)	$ (201)	$ (435)	$ (813)	$ (450)	$ (1,263)
Taxable investment securities (1)	654	(820)	(166)	2,042	(1,589)	453
Tax-exempt investment securities (2)	1,602	184	1,786	2,787	339	3,126
Loans (2) (3)	(580)	(2,324)	(2,904)	(270)	(7,870)	(8,140)
Interest income	1,442	(3,161)	(1,719)	3,746	(9,570)	(5,824)
Interest-bearing deposits	(81)	(4,255)	(4,336)	(331)	(10,316)	(10,647)
Short-term borrowings	44	(291)	(247)	318	(1,132)	(814)
Interest expense	(37)	(4,546)	(4,583)	(13)	(11,448)	(11,461)
Net interest income	$ 1,479	$ 1,385	$ 2,864	$ 3,759	$ 1,878	$ 5,637

(1) Trading securities are included in taxable investment securities.

(2) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.

(3) Nonaccrual loans are included in loans.

The net interest margin, which measures tax-equivalent net interest income as a percentage of average earning assets, is illustrated in Table 2.

The net interest margin for the second quarter of 2009 was 4.88%, an increase of 27 basis points from the same period in 2008. The net interest margin for the six-months of 2009 was 4.82%, an increase of 23 basis points from the same period in 2008.

Our net interest margin increased from prior periods despite the volatile interest rate environment which saw the Federal funds rate drop 400 basis points from January 2008 through June 2009. We have been more successful in implementing floors on our loans and have improved the pricing for loan risk, which previously we were unable to do due to competition. Additionally we have purchased investment securities at favorable yields. Should interest rates remain at the current low levels through the remainder of 2009, we anticipate that the impact of lower yields on loans and investment securities and competition for deposits may put pressure on our net interest margin.

Table 2 Average Balances and Average Yields and Rates (in thousands, except percentages):

	Three months ended June 30,					
	2009			2008		
	Average Balance	**Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Income/ Expense**	**Yield/ Rate**
Assets						
Short-term investments	$ 45,286	$ 71	0.63%	$ 96,494	$ 506	2.11%
Taxable investment securities (1)	885,382	9,209	4.16	827,589	9,376	4.53
Tax-exempt investment securities (2)	429,542	6,738	6.27	324,551	4,952	6.10
Loans (2)(3)	1,481,792	22,900	6.20	1,520,043	25,804	6.83
Total earning assets	2,842,002	38,918	5.49%	2,768,677	40,638	5.90%
Cash and due from banks	98,906			118,479		
Bank premises and equipment, net	64,498			63,528		
Other assets	36,135			30,526		
Goodwill and other intangible assets, net	63,675			64,746		
Allowance for loan losses	(22,938)			(18,616)		
Total assets	$ 3,082,278			$ 3,027,340		
Liabilities and Shareholders Equity						
Interest-bearing deposits	$ 1,735,640	$ 4,155	0.96%	$ 1,757,120	$ 8,491	1.94%
Short-term borrowings	171,936	192	0.45	156,849	440	1.13
Total interest-bearing liabilities	1,907,576	4,347	0.91%	1,913,969	8,931	1.88%
Noninterest-bearing deposits	753,473			740,688		
Other liabilities	32,134			20,774		
Total liabilities	2,693,183			2,675,431		
Shareholders equity	389,095			351,909		
Total liabilities and shareholders equity	$ 3,082,278			$ 3,027,340		

Net interest income	$ 34,571	$ 31,707
Rate Analysis:		
Interest income/earning assets	5.49%	5.90%
Interest expense/earning assets	0.61	1.29
Net yield on earning assets	4.88%	4.61%

	Six months ended June 30,					
	2009			2008		
	Average Balance	**Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Income/ Expense**	**Yield/ Rate**
Assets						
Short-term investments	$ 41,115	$ 113	0.56%	$ 105,705	$ 1,376	2.62%
Taxable investment securities (1)	895,102	18,947	4.23	806,059	18,493	4.59
Tax-exempt investment securities (2)	414,480	12,899	6.22	322,517	9,772	6.06
Loans (2)(3)	1,524,211	46,157	6.11	1,527,593	54,298	7.15
Total earning assets	2,874,908	78,116	5.48%	2,761,874	83,939	6.11%
Cash and due from banks	106,451			117,112		
Bank premises and equipment, net	64,898			63,091		
Other assets	37,096			31,032		
Goodwill and other intangible assets, net	63,782			64,903		
Allowance for loan losses	(22,507)			(18,225)		
Total assets	$ 3,124,628			$ 3,019,787		
Liabilities and Shareholders Equity						
Interest-bearing deposits	$ 1,751,263	$ 8,932	1.03%	$ 1,776,471	$ 19,579	2.22%
Short-term borrowings	201,416	454	0.45	160,559	1,268	1.59
Total interest-bearing liabilities	1,952,679	9,386	0.97%	1,937,030	20,847	2.16%
Noninterest-bearing deposits	754,851			715,334		
Other liabilities	32,119			19,785		
Total liabilities	2,739,649			2,672,149		
Shareholders equity	384,979			347,638		
Total liabilities and shareholders equity	$ 3,124,628			$ 3,019,787		
Net interest income		$ 68,730			$ 63,092	
Rate Analysis:						
Interest income/earning assets			5.48%			6.11%
Interest expense/earning assets			0.66			1.52
Net yield on earning assets			4.82%			4.59%

(1) Trading securities are included in taxable investment securities.

(2) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.

(3) Nonaccrual loans are included in loans.

Noninterest Income. Noninterest income for the second quarter of 2009 was $12.1 million, a decrease of $1.3 million, or 9.9%, as compared to the same period in 2008. This decrease is primarily due to (i) the student loan sale in the second quarter of 2008 compared to no sales in the second quarter in 2009, (ii) a decrease of $234 thousand in trust fees and (iii) a decrease of $250 thousand in service charges on deposits. This large decrease was offset by (i) an increase of $163 thousand in ATM and credit card fees primarily as a result of increased use of debit cards, (ii) an increase of $332 thousand in the net gain on securities transactions, and (iii) an increase of $93 thousand in real estate mortgage fees.

In the first quarter of 2009, we recorded a gain of $616 thousand on the sale of approximately $73.7 million in student loans, representing approximately 86% of our student loan portfolio. In the second quarter of 2008, we recognized a net gain of $1.4 million on the sale of $54.1 million in student loans. The Company has suspended its student loan origination activities as a result of changes mandated by the Department of Education that significantly reduced the profitability of the student loan program. It is currently anticipated that we will sell the remaining portfolio of student loans in the third quarter of 2009. The decline in trust fees reflects declines in the market values of the equity investments under management and lower oil and gas prices, offset in part by growth of $92.1 million in new business over the prior year. The fair value of our trust assets managed, which are not reflected in our balance sheet, totaled $1.99 billion at June 30, 2009 compared to $1.92 billion for the same period of 2008. The decline in service charges on deposit accounts was the result of a decrease in the usage of overdraft privilege.

Noninterest income for the six-month period ended June 30, 2009 was $23.7 million, a decrease of $2.1 million, or 8.2%, as compared to the same period in 2008. This decrease is primarily due to (i) the decrease of $1.1 million in profit from sale of student loans, (ii) a decrease of $486 thousand in trust fees and (iii) a decrease of $634 thousand in service charges on deposits. This large decrease was offset by (i) an increase of $341 thousand in ATM and credit card fees primarily as a result of increased use of debit cards, (ii) an increase of $188 thousand in the net gain on securities transactions, and (iii) an increase of $77 thousand in real estate mortgage fees.

In the first six months of 2009, we recorded a gain of $616 thousand on the sale of approximately $73.7 million in student loans, approximately 86% of our student loan portfolio. In the same period in 2008, we recognized a net gain of $1.7 million on the sale of $63.6 million in student loans.

Table 3 Noninterest Income (in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2009	Increase (Decrease)	2008	2009	Increase (Decrease)	2008
Trust fees	$ 2,125	$ (234)	$ 2,359	$ 4,242	$ (486)	$ 4,728
Service charges on deposit accounts	5,421	(250)	5,671	10,562	(634)	11,196
Real estate mortgage operations	858	93	765	1,446	77	1,369
Gain on sale of student loans		(1,432)	1,432	616	(1,099)	1,715
ATM and credit card fees	2,427	163	2,264	4,636	341	4,295
Net gain on securities transactions	498	332	166	747	188	559
Other:						
Net gain (loss) on sale of foreclosed assets	99	114	(15)	(59)	(148)	89
Check printing fees	102	(5)	107	208	(30)	238
Safe deposit rental fees	95	2	93	266	(4)	270
Exchange fees	23	(20)	43	42	(36)	78
Credit life and debt protection fees	51	3	48	89	(10)	99
Brokerage Commissions	54	(36)	90	111	(63)	174
Interest on loan recoveries	47	(81)	128	186	20	166
Miscellaneous income	320	16	304	564	(228)	792
Total other	791	(7)	798	1,407	(499)	1,906
Total Noninterest Income	$ 12,120	$ (1,335)	$ 13,455	$ 23,656	$ (2,112)	$ 25,768

Noninterest Expense. Total noninterest expense for the second quarter of 2009 was $24.4 million, an increase of $1.3 million, or 5.9%, as compared to the same period in 2008. An important measure in determining whether a banking company effectively manages noninterest expenses is the efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax-equivalent basis and noninterest income. Lower ratios indicate better efficiency since more income is generated with a lower noninterest expense total. Our efficiency ratio for the second quarter of 2009 was 52.17% compared to 50.95% for the same period in 2008.

Salaries and employee benefits for the second quarter of 2009 totaled $12.2 million, a decrease of $304 thousand, or 2.4%, as compared to 2008. The primary causes of this decrease were lower levels of contributions to the Company s profit sharing plan and a reduction in salaries from reduced headcount partially offset by a $239 thousand increase in medical costs.

All other categories of noninterest expense for the second quarter of 2009 totaled $12.1 million, an increase of $1.7 million, or 15.8%, as compared to the same period in 2008. The increase in noninterest expense was largely the result of an increase of approximately $2.2 million in FDIC insurance premiums, including the special assessment of $1.4 million. Depending upon the losses sustained by the FDIC in the remainder of 2009, there may be additional special assessments. The increase in FDIC insurance premiums is also the result of having utilized FDIC premium insurance credits in prior periods and an increase in 2009 of FDIC insurance premium rates. Net occupancy expense decreased $85 thousand primarily as a result of lower utilities expense. ATM and debit card interchange expenses decreased $368 thousand primarily as a result of better pricing with our processor.

Total noninterest expense for the first six-months of 2009 was $47.3 million, an increase of $1.6 million, or 3.6%, as compared to the same period in 2008. Our efficiency ratio for the first six-months of 2009 was 51.21% compared to 51.40% for the same period in 2008.

Salaries and employee benefits for the first six-months of 2009 totaled $24.2 million, a decrease of $860 thousand, or 3.4%, as compared to 2008. The primary cause of this decrease was lower levels of contributions to the Company s profit sharing plan.

All other categories of noninterest expense for the first six months of 2009 totaled $23.1 million, an increase of $2.5 million, or 12.1%, as compared to the same period in 2008. The increase in noninterest expense was largely the result of an increase of almost $3.0 million in FDIC insurance premiums, including the special assessment of $1.4 million. Depending upon the losses sustained by the FDIC in the remainder of 2009, there may be additional special assessments. The increase in FDIC insurance premiums is also the result of having utilized FDIC premium insurance credits in prior periods and an increase in 2009 of FDIC insurance premium rates. ATM and debit card interchange expenses decreased $450 thousand primarily as a result of better pricing with our processor. The increase in professional and service fees reflected higher costs associated with servicing the Company s student loans.

Table 4 Noninterest Expense (in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2009	Increase (Decrease)	2008	2009	Increase (Decrease)	2008
Salaries	$ 9,584	$ (146)	$ 9,730	$ 19,095	$ 113	$ 18,982
Medical	949	239	710	1,666	(103)	1,769
Profit sharing	555	(434)	989	1,050	(984)	2,034
Pension	80	1	79	160	3	157
401(k) match expense	298	19	279	601	37	564
Payroll taxes	704	2	702	1,525	51	1,474
Stock option expense	71	15	56	136	23	113
Total salaries and employee benefits	12,241	(304)	12,545	24,233	(860)	25,093