AUBURN NATIONAL BANCORPORATION INC
Form 10-Q
November 16, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended September 30, 2009

¨ **Transition report pursuant to Section 13 or 15(d) of the Exchange Act**
For the transition period __________ to __________

Commission File Number: 0-26486

Auburn National Bancorporation, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**63-0885779**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

100 N. Gay Street

Auburn, Alabama 36830

(334) 821-9200

(Address and telephone number of principal executive offices)

____

(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.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files).

Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

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

Class	**Outstanding at October 31, 2009**
Common Stock, $0.01 par value per share	3,643,117 shares

Table of Contents

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

INDEX

		PAGE
PART I. FINANCIAL INFORMATION		
Item 1	Financial Statements	
	Condensed Consolidated Balance Sheets (Unaudited) as September 30, 2009 and December 31, 2008	3
	Condensed Consolidated Statements of Earnings (Unaudited) for the quarter and nine months ended September 30, 2009 and 2008	4
	Condensed Consolidated Statement of Stockholders Equity and Comprehensive Income (Unaudited) for the nine months ended September 30, 2009 and 2008	5
	Condensed Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2009 and 2008	6
	Notes to Condensed Consolidated Financial Statements	7
Item 2	Management s Discussion and Analysis of Financial Condition and Results of Operations	23
	Table 1 Explanation of Use of Non-GAAP Financial Measures	40
	Table 2 Selected Quarterly Financial Data	42
	Table 3 Selected Financial Data	43
	Table 4 Average Balances and Net Interest Income Analysis for the quarters ended September 30, 2009 and 2008	44
	Table 5 Average Balances and Net Interest Income Analysis for the nine months ended September 30, 2009 and 2008	45
	Table 6 Loan Portfolio Composition	46
	Table 7 Allowance for Loan Losses and Nonperforming Assets	47
	Table 8 Allocation of Allowance for Loan Losses	48
	Table 9 CDs and Other Time Deposits of $100,000 or more	49
Item 3	Quantitative and Qualitative Disclosures About Market Risk	50
Item 4	Controls and Procedures	50
PART II. OTHER INFORMATION		
Item 1	Legal Proceedings	51
Item 1A	Risk Factors	51
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	51
Item 3	Defaults Upon Senior Securities	51
Item 4	Submission of Matters to a Vote of Security Holders	51
Item 5	Other Information	51
Item 6	Exhibits	52

Table of Contents

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands, except share data)	**September 30, 2009**	**December 31, 2008**
Assets:		
Cash and due from banks	$ 12,119	$ 14,832
Federal funds sold	9,050	20,755
Interest bearing bank deposits	1,537	846
Cash and cash equivalents	22,706	36,433
Securities available-for-sale	338,924	302,656
Loans held for sale	999	3,819
Loans, net of unearned income	385,448	369,162
Allowance for loan losses	(5,458)	(4,398)
Loans, net	379,990	364,764
Premises and equipment, net	8,362	7,778
Bank-owned life insurance	15,601	15,295
Other real estate	5,279	324
Other assets	14,181	14,901
Total assets	$ 786,042	$ 745,970
Liabilities:		
Deposits:		
Noninterest-bearing	$ 82,877	$ 78,013
Interest-bearing	514,714	472,830
Total deposits	597,591	550,843
Federal funds purchased and securities sold under agreements to repurchase	9,086	10,910
Long-term debt	118,355	123,368
Accrued expenses and other liabilities	2,605	3,721
Total liabilities	727,637	688,842
Stockholders equity:		
Preferred stock of $.01 par value; authorized 200,000 shares; issued shares - none		
Common stock of $.01 par value; authorized 8,500,000 shares; issued 3,957,135 shares	39	39
Additional paid-in capital	3,751	3,749
Retained earnings	59,406	59,283
Accumulated other comprehensive income, net	1,821	603
Less treasury stock, at cost - 313,038 shares and 310,188 shares for September 30, 2009 and December 31, 2008, respectively	(6,612)	(6,546)
Total stockholders equity	58,405	57,128
Total liabilities and stockholders equity	$ 786,042	$ 745,970

See accompanying notes to condensed consolidated financial statements

Table of Contents

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings

(Unaudited)

(Dollars in thousands, except share and per share data)	Three months ended September 30 2009	Three months ended September 30 2008	Nine months ended September 30 2009	Nine months ended September 30 2008
Interest income:				
Loans, including fees	$ 5,500	$ 5,571	$ 16,276	$ 16,937
Securities	3,672	3,970	11,405	11,866
Federal funds sold and interest bearing bank deposits	6	8	21	72
Total interest income	9,178	9,549	27,702	28,875
Interest expense:				
Deposits	3,300	3,575	10,329	11,448
Short-term borrowings	14	124	45	263
Long-term debt	1,202	1,257	3,622	3,778
Total interest expense	4,516	4,956	13,996	15,489
Net interest income	4,662	4,593	13,706	13,386
Provision for loan losses	1,100	380	2,350	620
Net interest income after provision for loan losses	3,562	4,213	11,356	12,766
Noninterest income:				
Service charges on deposit accounts	317	326	922	934
Mortgage lending	652	443	3,292	1,339
Bank-owned life insurance	98	116	306	354
Other	281	852	883	1,704
Securities (losses) gains, net:				
Realized gains (losses), net	561		2,465	95
Total other-than-temporary impairments	(315)		(6,735)	
Non-credit portion of other-than temporary impairments (transferred from) recognized in other comprehensive income	(435)		1,200	
Total securities (losses) gains, net	(189)		(3,070)	95
Total noninterest income	1,159	1,737	2,333	4,426
Noninterest expense:				
Salaries and benefits	1,858	1,952	5,881	5,526
Net occupancy and equipment	396	361	1,135	994
Professional fees	167	149	502	465
Other	1,000	834	3,380	2,565
Total noninterest expense	3,421	3,296	10,898	9,550
Earnings before income taxes	1,300	2,654	2,791	7,642
Income tax expense	277	682	590	1,952
Net earnings	$ 1,023	$ 1,972	$ 2,201	$ 5,690
Net earnings per share:				
Basic and diluted	$ 0.28	$ 0.54	$ 0.60	$ 1.55
Weighted average shares outstanding:				
Basic and diluted	3,644,097	3,677,509	3,645,128	3,679,820

See accompanying notes to condensed consolidated financial statements

Table of Contents

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders Equity and Comprehensive Income

(Unaudited)

(Dollars in thousands, except share and per share data)	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance, December 31, 2007	3,957,135	$ 39	$ 3,748	$ 55,362	$ (397)	$ (5,734)	$ 53,018
Comprehensive income:							
Net earnings				5,690			5,690
Other comprehensive loss due to change in unrealized loss on securities available for sale, net					(4,744)		(4,744)
Total comprehensive income				5,690	(4,744)		946
Cash dividends paid ($0.555 per share)				(2,042)			(2,042)
Stock repurchases (5,023 shares)						(113)	(113)
Sale of treasury stock (50 shares)			1				1
Balance, September 30, 2008	3,957,135	$ 39	$ 3,749	$ 59,010	$ (5,141)	$ (5,847)	$ 51,810
Balance, December 31, 2008	3,957,135	$ 39	$ 3,749	$ 59,283	$ 603	$ (6,546)	$ 57,128
Comprehensive income:							
Net earnings				2,201			2,201
Other comprehensive loss due to change in other-than-temporary impairment losses related to factors other than credit on available-for- sale, net					(757)		(757)
Other comprehensive income due to change in all other unrealized gains (losses) on securities available-for- sale, net					1,975		1,975
Total comprehensive income				2,201	1,218		3,419
Cash dividends paid ($0.57 per share)				(2,078)			(2,078)
Stock repurchases (2,955 shares)						(67)	(67)
Sale of treasury stock (105 shares)			2			1	3
Balance, September 30, 2009	3,957,135	$ 39	$ 3,751	$ 59,406	$ 1,821	$ (6,612)	$ 58,405

See accompanying notes to condensed consolidated financial statements

5

Table of Contents

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Nine months ended September 30 2009	2008
Cash flows from operating activities:		
Net earnings	$ 2,201	$ 5,690
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	2,350	620
Depreciation and amortization	513	269
Premium amortization and discount accretion, net	1,206	(10)
Net gain on sale of premises and equipment		(1,064)
Net loss (gain) on securities	3,070	(95)
Net gain on sale of loans held for sale	(3,036)	(1,105)
Net gain on sale of other real estate	(54)	
Loans originated for sale	(130,249)	(62,963)
Proceeds from sale of loans	135,294	64,435
Increase in cash surrender value of bank owned life insurance	(306)	(354)
Net increase in other assets	(1,435)	(456)
Net decrease in accrued expenses and other liabilities	(1,116)	(105)
Net cash provided by operating activities	8,438	4,862
Cash flows from investing activities:		
Proceeds from sales of securities available-for-sale	125,568	30,926
Proceeds from maturities of securities available-for-sale	95,319	51,934
Purchase of securities available-for-sale	(257,521)	(88,015)
Net increase in loans	(22,698)	(33,643)
Net purchases of premises and equipment	(823)	(1,810)
Proceeds from sale of premises and equipment		1,606
Other real estate improvements	(76)	
Proceeds from sale of other real estate	297	53
Net cash used in investing activities	(59,934)	(38,949)
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	4,864	8,646
Net increase in interest-bearing deposits	41,884	24,122
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(1,824)	1,889
Proceeds from issuance of long-term debt		13,000
Repayments or retirement of long-term debt	(5,013)	(14)
Proceeds from sale of treasury stock	3	1
Stock repurchases	(67)	(113)
Dividends paid	(2,078)	(2,042)
Net cash provided by financing activities	37,769	45,489
Net change in cash and cash equivalents	(13,727)	11,402
Cash and cash equivalents at beginning of period	36,433	13,498
Cash and cash equivalents at end of period	$ 22,706	$ 24,900
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 14,366	$ 15,550
Income taxes	1,830	2,134
Supplemental disclosure of non-cash transactions:		

Real estate acquired through foreclosure	5,122	647

See accompanying notes to condensed consolidated financial statements

Table of Contents

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Auburn National Bancorporation, Inc. (the Company) provides a full range of banking services to individual and corporate customers in Lee County, Alabama and surrounding counties through its subsidiary, AuburnBank (the Bank). The Company does not have any segments other than banking that are considered material.

Basis of Presentation and Use of Estimates

The unaudited condensed consolidated financial statements in this report have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include, in the opinion of management, all adjustments necessary to present a fair statement of the financial position and the results of operations for all periods presented. All such adjustments are of a normal recurring nature. The results of operations as of and for the nine months ended September 30, 2009, are not necessarily indicative of the results of operations that the Company and its subsidiaries may achieve for future interim periods or the entire year. For further information, refer to the consolidated financial statements and footnotes included in the Company s annual report on Form 10-K for the year ended December 31, 2008.

Reclassifications

Certain amounts reported in prior periods have been reclassified to conform to the current-period presentation. These reclassifications had no effect on the Company s previously reported net earnings or total stockholders equity.

Subsequent Events

The Company has evaluated the effects of subsequent events that have occurred subsequent to period end September 30, 2009, and through November 16, 2009, which is the date the Company issued its financial statements. During this period, there have been no material events that would require recognition in the third quarter 2009 condensed consolidated financial statements or disclosure in the Notes to the Condensed Consolidated Financial Statements.

Current Accounting Developments

Effective July 1, 2009, the Financial Accounting Standards Board (FASB) established the Accounting Standards Codification (ASC or the Codification) as the source of authoritative generally accepted accounting principles (GAAP) for companies to use in the preparation of financial statements. SEC rules and interpretive releases are also authoritative GAAP for SEC registrants. The guidance contained in the Codification supersedes all existing non-SEC accounting and reporting standards. The Company adopted the Codification, as required, in the third quarter of 2009. As a result, references to accounting literature contained in our financial statement disclosures have been updated to reflect the new Codification structure.

In the first quarter of 2009, the Company adopted new guidance related to the following Codification topics:

FASB ASC 805-10, *Business Combinations* (Statement of Financial Accounting Standards (SFAS) No. 141(R), *Business Combinations*);

FASB ASC 810-10, *Consolidation* (SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*);

FASB ASC 815-10, *Derivatives and Hedging* (SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*);

FASB ASC 820-10, *Fair Value Measurements and Disclosures* (FASB Staff Position (FSP) 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*); and

FASB ASC 320-10, *Investments Debt and Equity Securities* (FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*).

Table of Contents

In the second quarter of 2009, the Company adopted new guidance related to the following Codification topics:

FASB ASC 825-10, *Financial Instruments* (FSP FAS 107-1 and APB Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments)*; and

FASB ASC 855-10, *Subsequent Events* (SFAS No. 165, *Subsequent Events).*

In the third quarter of 2009, the Company adopted new guidance related to the following Codification topics:

FASB ASC 105-10, *Generally Accepted Accounting Principles* (SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162*).

Information about these pronouncements is described in more detail below.

FASB ASC 805-10 *Business Combinations,* (SFAS No. 141(R), *Business Combinations*) requires an acquirer in a business combination to recognize the assets acquired (including loan receivables), the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date at their fair values as of that date, with limited exceptions. The acquirer is not permitted to recognize a separate valuation allowance as of the acquisition date for loans and other assets acquired in a business combination. The revised statement requires acquisition-related costs to be expensed separately from the acquisition. It also requires restructuring costs that the acquirer expected but was not obligated to incur to be expensed separately from the business combination. This standard was applicable prospectively to business combinations completed on or after January 1, 2009. Adoption of revised FASB ASC 805-10 in the first quarter of 2009 had no impact on the consolidated financial statements of the Company.

FASB ASC 810-10, *Consolidation* (SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*) requires that noncontrolling interests (previously referred to as minority interests) be reported as a component of equity in the balance sheet. Prior to the Company s adoption of this standard, noncontrolling interests were classified outside of equity. This new guidance also changes the way a noncontrolling interest is presented in the income statement such that a parent s consolidated income statement includes amounts attributable to both the parent s interest and the noncontrolling interest. When a subsidiary is deconsolidated, a parent is required to recognize a gain or loss with any remaining interest initially recorded at fair value. Other changes in ownership interest where the parent continues to have a majority ownership interest in the subsidiary are accounted for as capital transactions. This new guidance was effective on January 1, 2009, with prospective application to all noncontrolling interests including those that arose prior to adoption. Retrospective adoption was required for disclosure of noncontrolling interests held as of the adoption date. Adoption of FASB ASC 810-10 in the first quarter of 2009 had no impact on the consolidated financial statements of the Company.

FASB ASC 815-10, *Derivatives and Hedging* (SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*) changes the disclosure requirements for derivative instruments and hedging activities. It requires enhanced disclosures about how and why an entity uses derivatives, how derivatives and related hedged items are accounted for, and how derivatives and hedged items affect an entity s financial position, performance and cash flows. The Company adopted this pronouncement during the first quarter of 2009. See Note 7 in this report for complete disclosures on derivatives and hedging activities. Adoption of this standard did not affect the Company s consolidated financial results since it amended only the disclosure requirements for derivative instruments and hedged items.

FASB ASC 820-10, *Fair Value Measurements and Disclosures* (FSP 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* addresses measuring fair value in situations where markets are inactive and transactions are not orderly. The guidance acknowledges that in these circumstances quoted prices may not be determinative of fair value; however, even if there has been a significant decrease in the volume and level of activity for an asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement has not changed. Under the provisions of this standard, price quotes for assets or liabilities in inactive markets may require adjustment due to uncertainty as to whether the underlying transactions are orderly. For inactive markets, there is little information, if any, to evaluate if individual transactions are orderly. Accordingly, the Company is required to estimate, based upon all available facts and circumstances, the degree to which orderly transactions are occurring. The Fair Value Measurements and Disclosures topic in the Codification does not prescribe a specific method for adjusting transaction or quoted prices; however, it does provide guidance for determining how much weight to give transaction or quoted prices. Price quotes based upon transactions that are not orderly are not considered to be determinative of fair value and should be given little, if any, weight in measuring

Table of Contents

fair value. Price quotes based upon transactions that are orderly shall be considered in determining fair value, with the weight given based upon the facts and circumstances. If sufficient information is not available to determine if price quotes are based upon orderly transactions, less weight should be given to the price quote relative to other transactions that are known to be orderly. The new measurement provisions of FASB ASC 820-10 were effective for second quarter 2009; however, as permitted under the pronouncement, the Company early adopted in first quarter 2009 and the effects of adoption were not significant.

FASB ASC 320-10, *Investments Debt and Equity Securities* (FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*) states that an other-than-tempoary impairment write-down of a debt security, where fair value is below amortized cost, is triggered in circumstances where (1) an entity has the intent to sell a security, (2) it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, or (3) the entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an other-than-temporary impairment write-down is recognized in earnings equal to the entire difference between the security s amortized cost basis and its fair value. If an entity does not intend to sell the security or it is more likely than not that it will not be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income. The new accounting requirements for recording other-than-temporary impairment on debt securities were effective for second quarter 2009; however, as permitted under the pronouncement, the Company early adopted on January 1, 2009. No adjustment was made to the beginning balance of retained earnings. See Note 4 in this report for additional disclosures required by FASB ASC 320-10.

FASB ASC 825-10, *Financial Instruments* (FSP FAS 107-1 and APB Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments)* states that entities must disclose the fair value of financial instruments in interim reporting periods as well as in annual financial statements. Entities must also disclose the methods and assumptions used to estimate fair value as well as any changes in methods and assumptions that occurred during the reporting period. The Company adopted this pronouncement in the second quarter of 2009. See Note 6 in this report for additional information. Because the new provisions in FASB ASC 825-10 amend only the disclosure requirements related to the fair value of financial instruments, adoption of this pronouncement did not affect the Company s consolidated financial results.

FASB ASC 855-10, *Subsequent Events* (SFAS No. 165, *Subsequent Events)* describes two types of subsequent events that previously were addressed in the auditing literature, one that requires post-period end adjustment to the financial statements being issued, and one that requires footnote disclosure only. Companies are also required to disclose the date through which management has evaluated subsequent events, which for public entities is the date that financial statements are issued. The requirements for disclosing subsequent events were effective in the second quarter of 2009 with prospective application. Adoption of this standard did not have a significant impact on the consolidated financial statements of the Company. See Note 1 (Summary of Significant Accounting Policies) in this report for the Company s discussion of subsequent events.

Table of Contents

NOTE 2: BASIC AND DILUTED EARNINGS PER SHARE

Basic net earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the quarter and nine months ended September 30, 2009 and 2008, respectively. Diluted net earnings per share reflect the potential dilution that could occur if the Company s potential common stock was issued. At September 30, 2009 and 2008, respectively, the Company had no options issued or outstanding.

A reconciliation of the numerator and denominator of the basic earnings per share computation to the diluted earnings per share computation for the quarter and nine months ended September 30, 2009 and 2009 are presented below.

	Quarter ended September 30		Nine months ended September 30	
(Dollars in thousands, except share and per share data)	**2009**	**2008**	**2009**	**2008**
Basic:				
Net earnings	$ 1,023	$ 1,972	$ 2,201	$ 5,690
Average common shares outstanding	3,644,097	3,677,509	3,645,128	3,679,820
Earnings per share	$ 0.28	$ 0.54	$ 0.60	$ 1.55
Diluted:				
Net earnings	$ 1,023	$ 1,972	$ 2,201	$ 5,690
Average common shares outstanding	3,644,097	3,677,509	3,645,128	3,679,820
Dilutive effect of options issued				
Average diluted shares outstanding	3,644,097	3,677,509	3,645,128	3,679,820
Earnings per share	$ 0.28	$ 0.54	$ 0.60	$ 1.55

NOTE 3: COMPREHENSIVE INCOME

Comprehensive income is defined as the change in equity from all transactions other than those with shareholders, and it includes net earnings and other comprehensive income. Comprehensive income for the quarter and nine months ended September 30, 2009 and 2008 is presented below.

	Quarter ended September 30		Nine months ended September 30	
(In thousands)	**2009**	**2008**	**2009**	**2008**
Comprehensive income:				
Net earnings	$ 1,023	$ 1,972	$ 2,201	$ 5,690
Other comprehensive income (loss):				
Change in other-than-temporary impairment losses related to factors other than credit on securities available-for-sale, net	274		(757)	
Change in all other unrealized gains (losses) on securities available-for-sale, net	4,852	(2,812)	1,975	(4,744)
Total comprehensive income (loss)	$ 6,149	$ (840)	$ 3,419	$ 946

Table of Contents

NOTE 4: SECURITIES

At September 30, 2009 and December 31, 2008, all securities within the scope of FASB ASC 320, *Investments Debt and Equity Securities* (SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*) were classified as available-for-sale. The fair value and amortized cost for securities available-for-sale at September 30, 2009 and December 31, 2008, by contractual maturity are presented below.

	September 30, 2009								
(Dollars in thousands)		1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Amortized cost
Available-for-sale:									
Agency obligations (a)	$			36,811	48,499	85,310	815	275	84,770
Agency ABS (a)					3,695	3,695		24	3,719
Agency RMBS (a)				5,731	155,321	161,052	3,454	203	157,801
State and political subdivisions			399	17,455	66,612	84,466	3,047	89	81,508
Trust preferred securities:									
Pooled					95	95		1,200	1,295
Individual issuer					1,585	1,585		1,865	3,450
Corporate debt			2,000	721		2,721		781	3,502
Total available-for-sale	$		2,399	60,718	275,807	338,924	7,316	4,437	336,045

(a) Includes securities issued by U.S. government agencies or government sponsored entities.

	December 31, 2008								
(Dollars in thousands)		1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Amortized cost
Available-for-sale:									
Agency obligations (a)	$			26,679	41,322	68,001	1,140		66,861
Agency RMBS (a)			3,522	24,949	126,608	155,079	4,228	80	150,931
Private label RMBS				3,088	2,491	5,579		152	5,731
State and political subdivisions			163	15,551	49,578	65,292	685	1,766	66,373
Trust preferred securities:									
Pooled					1,715	1,715		1,260	2,975
Individual issuer					3,559	3,559		1,766	5,325
Corporate debt			2,450	981		3,431		72	3,503
Total available-for-sale	$		6,135	71,248	225,273	302,656	6,053	5,096	301,699

(a) Includes securities issued by U.S. government agencies or government sponsored entities.

Securities with aggregate fair values of $234.2 million and $204.1 million at September 30, 2009 and December 31, 2008, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, Federal Home Loan Bank (FHLB) advances, and for other purposes required or permitted by law.

Included in other assets are cost-method investments. The carrying amounts of cost-method investments were $6.0 million and $7.9 million at September 30, 2009 and December 31, 2008, respectively. Cost-method investments primarily include Federal Home Loan Bank (FHLB) of Atlanta stock and Federal Reserve Bank stock.

Table of Contents

Gross Unrealized Losses and Fair Value

The fair values and gross unrealized losses on securities at September 30, 2009 and December 31, 2008, respectively, segregated by those securities that have been in an unrealized loss position for less than twelve months and twelve months or more are presented below.

	Less than 12 months		12 months or longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2009:						
Agency obligations	$ 25,783	275			25,783	275
Agency ABS	3,695	24			3,695	24
Agency RMBS	23,926	203			23,926	203
State and political subdivisions	2,404	14	2,988	75	5,392	89
Trust preferred securities:						
Pooled	49	226	46	974	95	1,200
Individual issuer			1,585	1,865	1,585	1,865
Corporate debt			2,721	781	2,721	781
Total	$ 55,857	742	7,340	3,695	63,197	4,437
December 31, 2008:						
Agency obligations	$					
Agency RMBS	6,367	40	4,162	40	10,529	80
Private label RMBS	5,579	152			5,579	152
State and political subdivisions	30,254	1,626	1,178	140	31,432	1,766
Trust preferred securities:						
Pooled	740	1,260			740	1,260
Individual issuer	2,524	1,351	1,035	415	3,559	1,766
Corporate debt	3,431	72			3,431	72
Total	$ 48,895	4,501	6,375	595	55,270	5,096

The applicable date for determining when securities are in an unrealized loss position is September 30, 2009. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the past twelve-month period.

For the securities in the above table, the Company does not have the intent to sell and has determined it is not more likely than not that the Company will be required to sell the security before recovery of the amortized cost basis, which may be maturity. The Company has assessed each security for credit impairment. For debt securities, the Company evaluates, where necessary, whether credit impairment exists by comparing the present value of the expected cash flows to the securities amortized cost basis. For cost-method investments, the Company evaluates whether an event or change in circumstances has occurred during the reporting period that may have a significant adverse effect on the fair value of the investment.

In determining whether a loss is temporary, the Company considers all relevant information including:

- the length of time and the extent to which the fair value has been less than the amortized cost basis;

- adverse conditions specifically related to the security, an industry, or a geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement);

the historical and implied volatility of the fair value of the security;

the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future;

failure of the issuer of the security to make scheduled interest or principal payments;

any changes to the rating of the security by a rating agency; and

recoveries or additional declines in fair value subsequent to the balance sheet date.

Table of Contents

To the extent the Company estimates future expected cash flows, the Company considered all available information in developing those expected cash flows. For asset-backed securities such as pooled trust preferred securities, such information generally included:

remaining payment terms of the security (including as applicable, terms that require underlying obligor payments to increase in the future);

current delinquencies and nonperforming assets of underlying collateral;

expected future default rates;

subordination levels or other credit enhancements.

Agency obligations

The unrealized losses associated with Agency obligations are primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities are issued by U.S. government agencies or government-sponsored entities and do not have any credit losses given the explicit or implicit government guarantee.

Agency asset-backed securities (ABS)

The unrealized losses associated with Agency ABS are primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities are issued by U.S. government agencies or government-sponsored entities and do not have any credit losses given the explicit or implicit government guarantee.

Agency residential mortgage-backed securities (RMBS)

The unrealized losses associated with Agency RMBS are primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities are issued by U.S. government agencies or government-sponsored entities and do not have any credit losses given the explicit or implicit government guarantee.

Securities of U.S. states and political subdivisions

The unrealized losses associated with securities of U.S. states and political subdivisions are primarily driven by changes in interest rates and are not due to the credit quality of the securities. These securities will continue to be monitored as part of the Company s quarterly impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond insurers. As a result, the Company expects to recover the entire amortized cost basis of these securities.

Pooled trust preferred securities

The unrealized losses associated with pooled trust preferred securities are primarily driven by higher projected collateral losses and wider credit spreads. Pooled trust preferred securities primarily consist of securities issued by community banks and thrifts. The Company assesses impairment for these securities using a cash flow model. The key assumptions include default probabilities of the underlying collateral and recoveries on collateral defaults. Based upon the Company s assessment of the expected credit losses for these securities, and given the performance of the underlying collateral compared to the Company s credit enhancement, the Company expects to recover the remaining amortized cost basis of these securities.

Individual issuer trust preferred securities

The unrealized losses associated with individual issuer trust preferred securities are primarily related to securities backed by individual issuer community banks. For individual issuers, management evaluates the financial performance of the issuer on a quarterly basis to determine if it is probable that the issuer can make all contractual principal and interest payments. Based upon its evaluation, the Company expects to recover the entire amortized cost basis of these securities.

Corporate debt securities

The unrealized losses associated with corporate debt securities are primarily related to securities backed by an individual issuer community bank. The Company evaluates the financial performance of the issuer on a quarterly basis to determine if it is probable that the issuer can make all contractual principal and interest payments. Based upon its evaluation, the Company expects to recover the entire amortized cost basis of these securities.

Table of Contents

Cost-method investments

At September 30, 2009, cost-method investments with an aggregate cost of $6.0 million were not evaluated for impairment because the Company did not identify any events or changes in circumstances that may have a significant adverse effect on the fair value of these cost-method investments.

The carrying values of the Company s investment securities could decline in the future if the underlying performance of the collateral for pooled trust preferred securities, the financial condition of individual issuers of trust preferred securities, or the credit quality of other securities deteriorate and the Company determines it is probable that it will not recover the entire amortized cost basis for the security. As a result, there is a risk that significant other-than-temporary impairment charges may occur in the future given the current economic environment.

The table below shows the applicable credit ratings, fair values, gross unrealized losses, and life-to-date impairment charges for pooled and individual issuer trust preferred securities at September 30, 2009 and December 31, 2008, respectively, segregated by those securities that have been in an unrealized loss position for less than twelve months and twelve months or more.

Trust Preferred Securities as of September 30, 2009

	Credit Rating			Unrealized losses			Life-to-date Impairment
(Dollars in thousands)	Moody s	Fitch	Fair value	Less than 12 months	12 months or longer	Total	Charges
Pooled:							
ALESCO Preferred Funding XVII, Ltd. (a)	Ca	B	$ 46	$	974	974	$ 980
U.S. Capital Funding IV, Ltd. (b)	Ca	CC	49	226		226	2,225
Total pooled			95	226	974	1,200	3,205
Individual issuer (c):							
Carolina Financial Capital Trust I	n/a	n/a	158		292	292	
Main Street Bank Statutory Trust I (d)	n/a	n/a	250		250	250	
MNB Capital Trust I	n/a	n/a	150		350	350	
PrimeSouth Capital Trust I	n/a	n/a	150		350	350	
TCB Trust	n/a	n/a	325		175	175	
United Community Capital Trust	n/a	n/a	552		448	448	
Total individual issuer			1,585		1,865	1,865	
Total trust preferred securities			$ 1,680	$ 226	2,839	3,065	$ 3,205

n/a - not applicable, securities not rated.

(a) Class B Deferrable Third Priority Secured Floating Rate Notes. The underlying collateral is primarily composed of community banks and thrifts.

(b) Class B-2 Fixed/Floating Rate Senior Surbordinate Notes. The underlying collateral is primarily composed of community banks and thrifts.

(c) 144A Floating Rate Capital Securities. Underlying issuer is a community bank holding company. Securities have no excess subordination or overcollateralization.

(d) Issuer acquired by BB&T Corporation.

Table of Contents

Trust Preferred Securities as of December 31, 2008

(Dollars in thousands)	Credit Rating Moody s	Fitch	Fair value	Unrealized losses Less than 12 months	12 months or longer	Total	Life-to-date Impairment Charges
Pooled:							
ALESCO Preferred Funding XVII, Ltd. (a)	Aa2	AA	$ 740	$ 1,260		1,260	$
U.S. Capital Funding IV, Ltd. (b)	Caa3	A-	975				1,525
Total pooled			1,715	1,260		1,260	1,525
Individual issuer (c):							
Carolina Financial Capital Trust I	n/a	n/a	329	121		121	
Community Financial Services Trust II (d)	n/a	n/a	272	228		228	
Community Financial Services Trust IV (d)	n/a	n/a	492	433		433	
Crescent Capital Trust II	n/a	n/a	272		178	178	
Main Street Bank Statutory Trust I (e)	n/a	n/a	422	78		78	
MNB Capital Trust I	n/a	n/a	408	92		92	
PrimeSouth Capital Trust I	n/a	n/a	366		134	134	
TCB Trust	n/a	n/a	397		103	103	
United Community Capital Trust	n/a	n/a	601	399		399	
Total individual issuer			3,559	1,351	415	1,766	
Total trust preferred securities			$ 5,274	$ 2,611	415	3,026	$ 1,525

n/a - not applicable, securities not rated.

(a) Class B Deferrable Third Priority Secured Floating Rate Notes. The underlying collateral is primarily composed of community banks and thrifts.

(b) Class B-2 Fixed/Floating Rate Senior Subordinate Notes. The underlying collateral is primarily composed of community banks and thrifts.

(c) 144A Floating Rate Capital Securities. Underlying issuer is a community bank holding company. Securities have no excess subordination or overcollateralization.

(d) Community Financial Services now known as Silverton.

(e) Issuer acquired by BB&T Corporation.

Table of Contents

For pooled trust preferred securities, the Company estimated expected future cash flows of the security by estimating the expected future cash flows of the underlying collateral and applying those collateral cash flows, together with any credit enhancements such as subordination interests owned by third parties, to the security. The expected future cash flows of the underlying collateral are determined using the remaining contractual cash flows adjusted for future expected credit losses (which consider default probabilities derived from issuer credit ratings for the underlying collateral). The probability-weighted expected future cash flows of the security are then discounted at the interest rate used to recognize income on the security to arrive at a present value amount.

Excess subordination is defined as the amount of performing collateral that is in excess of what is needed to payoff a specified class of securities and all classes senior to the specified class. Performing collateral is defined as total collateral minus all collateral that is currently deferring or currently in default. This definition assumes that all collateral that is currently deferring will default with a zero recovery rate. The underlying issuers can cure, or the bonds could recover a higher percentage upon default than zero. Excess subordination, as defined previously, does not consider any excess interest spread that is built into the structure of the security, which provides another source of repayment for the bonds.

The table below provides a detail of excess subordination levels for the Company s pooled trust preferred securities at September 30, 2009 and December 31, 2008.

(Dollars in thousands)	**September 30, 2009**	**December 31, 2008**
ALESCO Preferred Funding XVII, Ltd. - Class B notes		
Excess subordination		