VECTOR GROUP LTD
Form 10-Q
August 10, 2009

Table of Contents

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

VECTOR GROUP LTD.
(Exact name of registrant as specified in its charter)

Delaware	**1-5759**	**65-0949535**
(State or other jurisdiction of incorporation or organization)	Commission File Number	(I.R.S. Employer Identification No.)

100 S.E. Second Street
Miami, Florida 33131
305/579-8000
(Address, including zip code and telephone number, including area code, of the principal executive offices)

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, as amended (the Exchange Act), 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.
þ Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). o Yes o 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):

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

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

At August 10, 2009, Vector Group Ltd. had 66,527,070 shares of common stock outstanding.

VECTOR GROUP LTD.
FORM 10-Q
TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Vector Group Ltd. Condensed Consolidated Financial Statements (Unaudited):	
Condensed Consolidated Balance Sheets as of June 30, 2009 and December 31, 2008	2
Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2009 and June 30, 2008	3
Condensed Consolidated Statement of Stockholders Equity for the six months ended June 30, 2009	4
Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2009 and June 30, 2008	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	50
Item 3. Quantitative and Qualitative Disclosures About Market Risk	76
Item 4. Controls and Procedures	76
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	77
Item 1A. Risk Factors	77
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	77
Item 4. Submission of Matters to a Vote of Security Holders	78
Item 6. Exhibits	79
SIGNATURE	80

EX-31.1
EX-31.2
EX-32.1
EX-32.2
EX-99.1

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Vector Group Ltd. Condensed Consolidated Financial Statements (Unaudited)

VECTOR GROUP LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

	June 30, 2009	December 31, 2008
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 232,526	$ 211,105
Investment securities available for sale	42,219	28,518
Accounts receivable trade	9,511	9,506
Inventories	102,166	92,581
Deferred income taxes	5,444	3,642
Restricted assets	5,567	2,653
Other current assets	3,197	7,278
Total current assets	400,630	355,283
Property, plant and equipment, net	46,942	50,691
Mortgage receivable		17,704
Investment in real estate	12,204	
Long-term investments accounted for at cost	51,118	51,118
Investments in non-consolidated real estate businesses	43,820	50,775
Restricted assets	6,109	6,555
Deferred income taxes	58,207	45,222
Intangible asset	107,511	107,511
Prepaid pension costs	3,081	2,901
Other assets	27,609	29,952
Total assets	$ 757,231	$ 717,712
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities:		
Current portion of notes payable and long-term debt	$ 25,665	$ 97,498
Current portion of employee benefits	22,311	21,840
Accounts payable	6,471	6,104
Accrued promotional expenses	10,760	10,131
Income taxes payable, net	86,889	11,803
Accrued excise and payroll taxes payable, net	25,797	7,004
Settlement accruals	26,344	20,668
Deferred income taxes	15,706	92,507
Accrued interest	10,402	9,612
Other current liabilities	12,222	18,992

Total current liabilities	242,567	296,159
Notes payable, long-term debt and other obligations, less current portion	253,681	210,301
Fair value of derivatives embedded within convertible debt	136,796	77,245
Non-current employee benefits	36,314	34,856
Deferred income taxes	61,070	48,807
Other liabilities	24,138	16,739
Total liabilities	754,566	684,107
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $1.00 per share, 10,000,000 shares authorized		
Common stock, par value $0.10 per share, 150,000,000 shares authorized, 69,620,319 and 69,107,320 shares issued and 66,527,070 and 66,014,070 shares outstanding	6,652	6,601
Additional paid-in capital	39,207	65,103
Retained earnings (accumulated deficit)	(4,846)	
Accumulated other comprehensive loss	(25,491)	(25,242)
Less: 3,093,250 and 3,093,250 shares of common stock in treasury, at cost	(12,857)	(12,857)
Total stockholders equity	2,665	33,605
Total liabilities and stockholders equity	$ 757,231	$ 717,712

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

Table of Contents

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues*	$ 206,794	$ 142,960	$ 328,010	$ 275,165
Expenses:				
Cost of goods sold*	147,764	86,030	220,290	166,037
Operating, selling, administrative and general expenses	20,183	22,585	41,713	46,742
Gain on brand transaction			(5,000)	
Restructuring charges			1,000	
Operating income	38,847	34,345	70,007	62,386
Other income (expenses):				
Interest and dividend income	76	1,375	226	3,346
Interest expense	(17,086)	(15,257)	(33,160)	(30,510)
Loss on extinguishment of debt	(18,444)		(18,444)	
Change in fair value of derivatives embedded within convertible debt	(19,488)	9,759	(19,791)	7,315
Impairment charges on investments			(8,500)	
Equity income from non-consolidated real estate businesses	1,811	4,184	816	17,504
Other, net		(4)		(577)
(Loss) income before provision for income taxes	(14,284)	34,402	(8,846)	59,464
Income tax (benefit) expense	(6,338)	15,277	(4,000)	26,032
Net (loss) income	$ (7,946)	$ 19,125	$ (4,846)	$ 33,432
Per basic common share:				
Net (loss) income applicable to common shares	$ (0.12)	$ 0.29	$ (0.07)	$ 0.50
Per diluted common share:				
Net (loss) income applicable to common shares	$ (0.12)	$ 0.24	$ (0.07)	$ 0.49
Cash distributions and dividends declared per share	$ 0.40	$ 0.38	$ 0.80	$ 0.76

* Revenues and Cost of goods sold include excise taxes of $103,458, $43,201, $137,170 and $83,723, respectively.

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

Table of Contents

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT
(Dollars in Thousands, Except Share Amounts)
Unaudited

	Common Stock		Additional Paid-In		Accumulated Other Comprehensive Income	Treasury	
	Shares	Amount	Capital	Deficit	(Loss)	Stock	Total
Balance, December 31, 2008	66,014,070	$ 6,601	$ 65,103	$	$ (25,242)	$ (12,857)	$ 33,605
Net loss				(4,846)			(4,846)
Pension-related minimum liability adjustments, net of taxes					302		302
Forward contract adjustments, net of taxes					17		17
Unrealized loss on investment securities, net of taxes					(568)		(568)
Total other comprehensive income							(249)
Total comprehensive loss							(5,095)
Distributions and dividends on common stock			(55,598)				(55,598)
Restricted stock grant	500,000	50					50
Exercise of options	13,000	1	130				131
Excess tax benefit of options exercised			13				13
Amortization of deferred compensation			2,033				2,033
Beneficial conversion feature of notes payable, net of taxes			27,526				27,526

Balance, June 30, 2009	66,527,070	$ 6,652	$ 39,207	$ (4,846)	$ (25,491)	$ (12,857)	$ 2,665

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

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Net cash provided by operating activities	$ 52,553	$ 35,885
Cash flows from investing activities:		
Purchase of investment securities	(10,667)	(5,182)
Proceeds from sale or liquidation of long-term investments	1,407	8,334
Purchase of long-term investments		(51)
Purchase of mortgage receivable		(21,704)
Distributions from non-consolidated real estate businesses	2,364	16,446
Investment in non-consolidated real estate assets		(10,000)
Increase in cash surrender value of life insurance policies	(757)	(521)
Decrease (increase) in non-current restricted assets	446	(259)
Proceeds from sale of fixed assets		373
Capital expenditures	(1,409)	(2,456)
Net cash used in investing activities	(8,616)	(15,020)
Cash flows from financing activities:		
Proceeds from debt issuance	38,246	
Repayments of debt	(3,052)	(2,984)
Deferred financing charges	(216)	(137)
Borrowings under revolver	306,788	255,118
Repayments on revolver	(306,167)	(256,753)
Dividends and distributions on common stock	(58,310)	(52,737)
Excess tax benefit of options exercised	13	18,283
Proceeds from exercise of options	182	26
Net cash used in financing activities	(22,516)	(39,184)
Net increase (decrease) in cash and cash equivalents	21,421	(18,319)
Cash and cash equivalents, beginning of period	211,105	238,117
Cash and cash equivalents, end of period	$ 232,526	$ 219,798

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

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

The condensed consolidated financial statements of Vector Group Ltd. (the Company or Vector) include the accounts of VGR Holding LLC (VGR Holding), Liggett Group LLC (Liggett), Vector Tobacco Inc. (Vector Tobacco), Liggett Vector Brands Inc. (Liggett Vector Brands), New Valley LLC (New Valley) and other less significant subsidiaries. All significant intercompany balances and transactions have been eliminated.

Liggett is engaged in the manufacture and sale of cigarettes in the United States. Vector Tobacco is engaged in the marketing of low nicotine and nicotine-free cigarette products and the development of reduced risk cigarette products. New Valley is engaged in the real estate business and is seeking to acquire additional operating companies and real estate properties.

The interim condensed consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to state fairly the Company s consolidated financial position, results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

(b) Distributions and Dividends on Common Stock:

The Company records distributions on its common stock as dividends in its condensed consolidated statement of stockholders equity to the extent of retained earnings. Any amounts exceeding retained earnings are recorded as reductions to additional paid-in capital.

(c) Earnings Per Share (EPS):

Information concerning the Company s common stock has been adjusted to give retroactive effect to the 5% stock dividend paid to Company stockholders on September 29, 2008. All per share amounts have been presented as if the stock dividends had occurred on January 1, 2008.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

The Company has stock option awards which provide for common stock dividends at the same rate as paid on the common stock with respect to the shares underlying the unexercised portion of the options. As a result, in its calculation of basic EPS for the three and six months ended June 30, 2009 and 2008, the Company has adjusted its net income for the effect of its participating securities as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net (loss) income	$ (7,946)	$ 19,125	$ (4,846)	$ 33,432
Loss (income) attributable to participating securities	364	(871)	222	(1,553)
Net (loss) income available to common stockholders	$ (7,582)	$ 18,254	$ (4,624)	$ 31,879

Basic EPS is computed by dividing net income available to common stockholders by the weighted-average number of shares outstanding.

Diluted EPS is computed by dividing net income available to common stockholders by the diluted weighted-average number of shares outstanding, which includes dilutive non-vested restricted stock grants, stock options and convertible securities. Diluted EPS includes the dilutive effect of stock options, unvested restricted stock grants and convertible securities. However, in its calculation of diluted EPS for the three and six months ended June 30, 2009 and 2008, the Company has adjusted its net income for the effect of the participating securities, stock options, unvested restricted stock grants and convertible securities as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net (loss) income	$ (7,946)	$ 19,125	$ (4,846)	$ 33,432
(Income) expenses attributable to 3.875% convertible debentures		(1,500)		2,527
Income attributable to participating securities	364	(803)	222	(1,670)
Net income available to common stockholders	$ (7,582)	$ 16,822	$ (4,624)	$ 34,289

Basic and diluted EPS were calculated using the following shares for the three and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Weighted-average shares for basic EPS	65,812,958	63,496,622	65,807,960	63,234,165
Plus incremental shares related to stock options and non-vested restricted stock		1,296,157		1,471,471

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Plus incremental shares related to convertible debt		5,923,077		5,923,077
Weighted-average shares for fully diluted EPS	65,812,958	70,715,856	65,807,960	70,628,713

The Company s non-vested restricted share grants contain rights to receive forfeitable dividends, and thus are not participating securities requiring the two class method of computing EPS.

The following stock options, non-vested restricted stock and shares issuable upon the conversion of convertible debt were outstanding during the three and six months ended June 30, 2008 but were not included in the computation of diluted EPS because the exercise prices of the options and the per share expense associated with the restricted stock were greater than the average market price of the common shares during the respective periods, and the impact of common shares issuable under the convertible debt were anti-dilutive to EPS. Amounts presented for the three and six months ended June 30, 2009 were not included in the computation of diluted EPS because the Company reported a loss during such period and the impact was anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Number of stock options	5,271,881	516,147	5,271,881	516,147
Weighted-average exercise price	$ 11.59	$ 19.25	$ 11.59	$ 19.25
Weighted-average shares of non-vested restricted stock	658,156	407,920	428,662	118,514
Weighted-average expense per share	$ 14.17	$ 17.09	$ 14.83	$ 17.59
Weighted-average number of shares issuable upon conversion of debt	14,380,320	7,008,186	13,660,437	7,008,186
Weighted-average conversion price	$ 16.92	$ 15.96	$ 16.63	$ 15.96

(d) Comprehensive Income:

Other comprehensive income is a component of stockholders equity and includes such items as the unrealized gains and losses on investment securities available for sale, forward foreign contracts and minimum pension liability adjustments. The Company s comprehensive loss was $3,882 and $5,095 for the three and six months ended June 30, 2009. The Company s comprehensive income was $14,463 and $25,444 for the three and six months ended June 30, 2008.

(e) Fair Value of Derivatives Embedded within Convertible Debt:

The Company has estimated the fair market value of the embedded derivatives based principally on the results of a valuation model. The estimated fair value of the derivatives embedded within the convertible debt is based principally on the present value of future dividend payments expected to be received by the convertible debt

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

holders over the term of the debt. The discount rate applied to the future cash flows is estimated based on a spread in the yield of the Company s debt when compared to risk-free securities with the same duration; thus, a readily determinable fair market value of the embedded derivatives is not available. The valuation model assumes future dividend payments by the Company and utilizes interest rates and credit spreads for secured to unsecured debt, unsecured to subordinated debt and subordinated debt to preferred stock to determine the fair value of the derivatives embedded within the convertible debt. The valuation also considers other items, including current and future dividends and the volatility of Vector s stock price. The range of estimated fair market values of the Company s embedded derivatives was between $134,269 and $139,419. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at $136,796 as of June 30, 2009. The estimated fair market value of the Company s embedded derivatives could change significantly based on future market conditions. (See Note 6.)

(f) Capital and Credit Market Crisis

During the recent capital and credit market crisis, the Company has performed additional assessments to determine the impact, if any, of market developments, on the Company s consolidated condensed financial statements. The Company s additional assessments have included a review of access to liquidity in the capital and credit markets, counterparty creditworthiness, value of the Company s investments (including long-term investments, mortgage receivable and employee benefit plans) and macroeconomic conditions. The recent unprecedented volatility in capital and credit markets may create additional risks in the upcoming months and possibly years and the Company will continue to perform additional assessments to determine the impact, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

On a quarterly basis, the Company evaluates its investments to determine whether an impairment has occurred. If so, the Company also makes a determination of whether such impairment is considered temporary or other-than-temporary. The Company believes that the assessment of temporary or other-than-temporary impairment is facts and circumstances driven. However, among the matters that are considered in making such a determination are the period of time the investment has remained below its cost or carrying value, the likelihood of recovery given the reason for the decrease in market value and the Company s original expected holding period of the investment.

(g) Contingencies:

The Company records Liggett s product liability legal expenses and other litigation costs as operating, selling, general and administrative expenses as those costs are incurred. As discussed in Note 8, legal proceedings covering a wide range of matters are pending or threatened in various jurisdictions against Liggett.

The Company and its subsidiaries record provisions in their consolidated financial statements for pending litigation when they determine that an unfavorable outcome is probable and the amount of loss can be reasonably estimated. Management is unable to make a reasonable estimate with respect to the amount or range of loss that could result from an unfavorable outcome of pending tobacco-related litigation or the costs of defending such cases, and the Company has not provided any amounts in its consolidated financial statements for unfavorable outcomes, if any, unless specified in Note 8. Litigation is subject to many uncertainties, and it is possible that the Company s consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any such tobacco-related litigation.

(h) New Accounting Pronouncements:

On January 1, 2008, Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157) for financial assets and financial liabilities became effective for the Company. SFAS No. 157 does not require any new fair value measurements but provides a definition of fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. On January 1, 2009, the Company adopted SFAS No. 157 as it relates to nonfinancial assets and nonfinancial liabilities that are not recognized or

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

disclosed at fair value in the financial statements on at least an annual basis. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America (GAAP), and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements and are to be applied prospectively with limited exceptions. The adoption of SFAS No. 157 did not have a material impact on the Company s condensed consolidated financial statements. (See Note 11.)

On January 1, 2009, SFAS No. 141(R), a revised version of SFAS No. 141, Business Combinations and FSP No. 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies became effective for the Company. The revision is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. The adoption of this standard did not have a material impact on the Company s condensed consolidated financial statements.

On January 1, 2009, SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133 became effective for the Company. SFAS No. 161 seeks qualitative disclosures about the objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. SFAS No. 161 also seeks enhanced disclosure around derivative instruments in financial statements, accounting under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and how hedges affect an entity s financial position, financial performance and cash flows. The adoption of SFAS No. 161 did not have a material impact on the Company s condensed consolidated financial statements.

On January 1. 2009, FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP No. APB 14-1) became effective for the Company. The adoption of FSP No. APB 14-1 had no impact on the Company s condensed consolidated financial statements.

On January 1, 2009, FSP No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, (FSP EITF 03-6-1) became effective for the Company. FSP EITF 03-6-1 states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The adoption of FSP EITF 03-6-1 had no impact on the Company s condensed consolidated financial statements.

In April 2009, FSP SFAS 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 became effective for the Company. FSP FAS No. 157-4 clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. FSP FAS No. 157-4 also reaffirms the objective of fair value measurement, as stated in FAS No. 157, Fair Value Measurements, which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. The adoption of FSP SFAS 157-4 had no impact on the Company s condensed consolidated financial statements.

In April 2009, FSP FAS No. 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP No. 115-2 and FAS No. 124-2) became effective for the Company. FSP FAS No. 115-2 and FAS No. 124-2 modifies the other-than-temporary impairment guidance for debt securities through increased consistency in the timing of impairment recognition and enhanced disclosures related to the credit and noncredit components of impaired debt securities that are not expected to be sold. In addition, increased disclosures are required for both debt and equity securities regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. The adoption of FSP FAS No. 115-2 and FAS No. 124-2 did not have a material

impact on the condensed consolidated financial statements.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In April 2009, FSP FAS No. 107-1 and APB Opinion No. 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS No. 107-1 and APB Opinion No. 28-1) became effective for the Company. FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. The adoption of FSP FAS No. 107-1 and APB Opinion No. 28-1 did not have a material impact on the Company s condensed consolidated financial statements.

In December 2008, the Financial Accounting Standards Board (FASB) issued FSP SFAS 132(R)-1 Employers Disclosures about Postretirement Benefit Plan Assets. This FSP amends the disclosure requirements for employer s disclosure of plan assets for defined benefit pensions and other postretirement plans. The objective of this FSP is to provide users of financial statements with an understanding of how investment allocation decisions are made, the major categories of plan assets held by the plans, the inputs and valuation techniques used to measure the fair value of plan assets, significant concentration of risk within the company s plan assets, and for fair value measurements determined using significant unobservable inputs a reconciliation of changes between the beginning and ending balances. FSP SFAS 132(R)-1 is effective for fiscal years ending after December 15, 2009. The Company will adopt the new disclosure requirements in the 2009 annual reporting period.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (the Codification) (SFAS No. 168). The Codification, which was launched on July 1, 2009, became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. The Codification eliminates the GAAP hierarchy contained in SFAS No. 162 and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company will adopt this Statement for its quarter ending September 30, 2009. The Company is evaluating the impact of SFAS No. 168 on its condensed consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), and SFAS No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140. SFAS No. 167 amends FASB Interpretation 46(R) to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and requires ongoing qualitative reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. SFAS No. 166 amends SFAS No. 140 by removing the exemption from consolidation for Qualifying Special Purpose Entities (QSPEs). This Statement also limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset. The Company will adopt these Statements for interim and annual reporting periods beginning on January 1, 2010. The Company is currently assessing the impact, if any, of SFAS No. 167 on its condensed consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events . This Statement sets forth: 1) 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; 2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements;

and 3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This Statement is effective for interim and annual periods ending after June 15, 2009. The Company adopted this Statement in the quarter ended June 30, 2009. This Statement did not impact the Company s condensed consolidated financial statements.

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

2. RESTRUCTURING

In March 2009, Vector Tobacco eliminated nine full-time positions in connection with the decision by the Company s Board of Directors in 2006 to discontinue the genetics operation and not to pursue FDA approval of QUEST as a smoking cessation aide, due to the projected significant additional time and expense involved in seeking such approval.

The Company recognized pre-tax restructuring charges of $1,000, during the first quarter of 2009. The restructuring charges primarily related to employee severance and benefit costs. The remaining balance of the severance and benefit costs restructuring charges was $789 as of June 30, 2009. Approximately $211 was utilized during the three and six months ended June 30, 2009, respectively.

The only remaining component of the 2004 Liggett Vector Brands restructuring at June 30, 2009 and December 31, 2008 was contract termination and exit costs of $396 and $461, respectively. Approximately $22 and $65 was utilized during the three and six months ended June 30, 2009, respectively.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains or losses included as a component of stockholders equity, net of income taxes. The components of investment securities available for sale at June 30, 2009 were as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Marketable equity securities	$ 39,621	$ 9,548	$ (6,950)	$ 42,219

In October 2008, the Company purchased 320,000 shares of Castle Brands, Inc. (Castle Brands) Series A Convertible Preferred Stock for $4,000. Castle Brands is a publicly-traded developer and importer of premium branded spirits. The purchase was accounted for at historical cost and included with Other Assets on the condensed balance sheet at December 31, 2008. In January 2009, the Series A Preferred Stock of Castle Brands were converted into 11,428,576 shares of Common Stock. Effective with the conversion, the Castle Brands shares have been accounted for as an investment held for sale. These shares were carried at $2,514 as of June 30, 2009.

In May and June 2009, the Company purchased 3,683,526 common shares of Strategic Hotels & Resorts, Inc. (Strategic Hotels) for approximately $5,553, excluding commissions. The shares were carried at $4,089 as of June 30, 2009. The Company purchased an additional 1,650,000 shares in July 2009 for approximately $1,584, excluding commissions. On July 20, 2009, the Company reported that it owned approximately 7.1% of the stock of Strategic Hotels.

Investment securities available for sale as of June 30, 2009 and December 31, 2008 include New Valley s 13,891,205 shares of Ladenburg Thalmann Financial Services Inc. (LTS) common stock, which were carried at $7,500 and $10,000, respectively. Investment securities available for sale as of June 30, 2009 and December 31, 2008 also include 10,057,110 and 5,057,110 shares, respectively, of Opko Health Inc. (Opko) common stock, which were carried at $17,801 and $8,193, respectively. In May 2009, the Company purchased an additional 5,000,000 shares of Opko in a private placement for $5,000. These shares have not been registered for resale but are expected to be freely tradable within one year.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In 2008, the Company acquired 2,259,796 shares of Cardo Medical, Inc. for $500. The shares were carried at $2,825 and $3,277 as of June 30, 2009 and December 31, 2008. These shares are now freely tradable.

4. INVENTORIES

Inventories consist of:

	June 30, 2009	December 31, 2008
Leaf tobacco	$ 50,163	$ 48,880
Other raw materials	5,661	5,128
Work-in-process	1,034	314
Finished goods	57,701	46,202
Inventories at current cost	114,559	100,524
LIFO adjustments	(12,393)	(7,943)
	$ 102,166	$ 92,581

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the commitment date. At June 30, 2009, Liggett had leaf tobacco purchase commitments of approximately $16,633. There were no leaf tobacco purchase commitments at Vector Tobacco at that date. During 2007, the Company entered into a single source supply agreement for fire safe cigarette paper through 2012.

The Company capitalizes the incremental prepaid cost of the Master Settlement Agreement in ending inventory. For the six months ended June 30, 2009 and 2008, the Company s MSA expense was increased by approximately $650 for 2008 and reduced by approximately $1,300 for 2007, respectively, as a result of a change in estimate to the MSA assessment.

LIFO inventories represent approximately 94% and 95% of total inventories at June 30, 2009 and December 31, 2008, respectively.

5. LONG-TERM INVESTMENTS

Long-term investments consist of investments in the following:

	June 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investment partnerships accounted for at cost	$ 51,118	$ 63,072	$ 51,118	$ 54,997

The principal business of these investment partnerships is investing in investment securities and real estate. The estimated fair value of the investment partnerships was provided by the partnerships based on the indicated market values of the underlying assets or investment portfolio. The investments in these investment partnerships are illiquid and the ultimate realization of these investments is subject to the performance of the underlying partnership and its management by the general partners.

The long-term investments are carried on the condensed consolidated balance sheet at cost. The fair value determination disclosed above would be classified as Level 3 under the SFAS 157 hierarchy disclosed in Note 11

-13-

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

if such assets were recorded on the condensed consolidated balance sheet at fair value. The fair values were determined based on unobservable inputs and were based on company assumptions, and information obtained from the partnerships based on the indicated market values of the underlying assets of the investment portfolio. The changes in the fair value of these investments as of June 30, 2009 were as follows:

		Investment Partnerships Accounted for at Cost
Balance as of January 1, 2009	$	54,997
Unrealized loss on long-term Investments		(357)
Realized gain (loss) on long-term Investments		
Balance as of March 31, 2009		54,640
Unrealized gain on long-term Investments		8,432
Realized gain (loss) on long-term investments		
Balance as of June 30, 2009	$	63,072

The changes in the fair value of these investments as of June 30, 2008 were as follows:

		Investment Partnerships Accounted for at Cost		Investment Partnerships Accounted for on the Equity Method
Balance as of January 1, 2008	$	89,007	$	10,495
Unrealized loss on long-term Investments		(2,034)		(675)
Realized loss on long-term Investments				(567)
Balance as of March 31, 2008		86,973		9,253
Contributions (distributions)		47		(8,328)
Unrealized loss on long-term Investments		(3,767)		
Realized gain on long-term Investments		14		
Receivable classified as Other currents assets				(925)
Balance as of June 30, 2008	$	83,267	$	

The Company will continue to perform additional assessments of the investments and the current condition of capital and credit markets to determine the impact, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

In the future, the Company may invest in other investments, including limited partnerships, real estate investments, equity securities, debt securities, derivatives and certificates of deposit, depending on risk factors and potential rates of return.

-14-

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

6. NOTES PAYABLE, LONG-TERM DEBT AND OTHER OBLIGATIONS

Notes payable, long-term debt and other obligations consist of:

	June 30, 2009	December 31, 2008
Vector:		
11% Senior Secured Notes due 2015	$ 165,000	$ 165,000
6.75% Variable Interest Senior Convertible Note due 2014, net of unamortized discount of $40,245 and $0*	9,755	
6.75% Variable Interest Senior Convertible Exchange Notes due 2014, net of unamortized discount of $71,292 and $0*	35,648	
3.875% Variable Interest Senior Convertible Debentures due 2026, net of unamortized discount of $83,785 and $83,993*	26,215	26,007
5% Variable Interest Senior Convertible Notes due 2011, net of unamortized net discount of $270 and $39,565*	645	72,299
Liggett:		
Revolving credit facility	20,135	19,515
Term loan under credit facility	7,022	7,290
Equipment loans	6,403	8,307
V.T. Aviation:		
Note payable	4,580	5,266
VGR Aviation:		
Note payable	3,873	4,053
Other	70	62
Total notes payable, long-term debt and other obligations	279,346	307,799
Less:		
Current maturities	(25,665)	(97,498)
Amount due after one year	$ 253,681	$ 210,301

* The fair value of the derivatives embedded within the 6.75% Variable Interest Senior

Convertible Exchange Notes ($44,070 at June 30, 2009 and $0 at December 31, 2008), 6.75% Variable Interest Convertible Note ($23,376 at June 30, 2009 and $0 at December 31, 2008), 3.875% Variable Interest Senior Convertible Debentures ($69,158 at June 30, 2009 and $51,829 at December 31, 2008) and the 5% Variable Interest Senior Convertible Notes ($192 at June 30, 2009 and $25,416 at December 31, 2008) is separately classified as a derivative liability in the condensed consolidated balance sheets.

11% Senior Secured Notes due 2015 Vector:

In August 2007, the Company sold $165,000 in 11% Senior Secured Notes due 2015 (the Senior Secured Notes) in a private offering to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933. On May 28, 2008, the Company completed an offer to exchange the Senior Secured Notes for an equal amount of newly issued 11% Senior Secured Notes due 2015. The new Senior Secured Notes have substantially the same terms as the original notes, except that the new Senior Secured Notes have been registered under the Securities Act.

The indenture contains covenants that restrict the payment of dividends by the Company if the Company s consolidated earnings before interest, taxes, depreciation and amortization (Consolidated EBITDA), as defined in the indenture, for the most recently ended four full quarters is less than $50,000. The indenture also restricts the incurrence of debt if the Company s Leverage Ratio and its Secured Leverage Ratio, as defined in the indenture,

exceed 3.0 and 1.5, respectively. The Company s Leverage Ratio is defined in the indenture as the ratio of the Company s and the guaranteeing subsidiaries total debt less the fair market value of the Company s cash, investments in marketable securities and long-term investments to Consolidated EBITDA, as defined in the indenture. The Company s Secured Leverage Ratio is defined in the indenture in the same manner as the Leverage Ratio, except that secured indebtedness is substituted for indebtedness.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

The following table summarizes the requirements of these financial covenants and the results of the calculation, as defined by the indenture.

Covenant	Indenture Requirement	June 30, 2009	December 31, 2008
Consolidated EBITDA, as defined	$50,000	$160,014	$154,053
Leverage ratio, as defined	<3.0 to 1	Negative	0.1 to 1
Secured leverage ratio, as defined	<1.5 to 1	Negative	Negative

Variable Interest Senior Convertible Debt Vector:

Vector has issued four series of variable interest senior convertible debt. All four series of debt pay interest on a quarterly basis at a stated rate plus an additional amount of interest on each payment date. The additional amount is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt would be convertible on such record date.

5% Variable Interest Senior Convertible Notes due November 2011:

Between November 2004 and April 2005, the Company sold $111,864 principal amount of its 5% Variable Interest Senior Convertible Notes due November 15, 2011 (the 5% Notes). In May 2009, the holder of $11,005 principal amount of the 5% Notes exchanged its 5% Notes for $11,775 principal amount of the Company s 6.75% Variable Interest Senior Convertible Note due 2014 (the 6.75% Note) as discussed below. In June 2009, certain holders of $99,944 principal amount of the 5% Notes exchanged their 5% Notes for $106,940 principal amount of the Company s 6.75% Variable Interest Senior Convertible Exchange Notes due 2014 of the Company (the 6.75% Exchange Notes). As of June 30, 2009, a total of $915 principal amount of the 5% Notes remained outstanding after these exchanges.

6.75% Variable Interest Senior Convertible Note due 2014:

On May 11, 2009, the Company issued in a private placement the 6.75% Note in the principal amount of $50,000. The purchase price was paid in cash ($38,225) and by tendering $11,005 principal amount of the 5% Notes, valued at 107% of principal amount. The note pays interest (Total Interest) on a quarterly basis at a rate of 3.75% per annum plus additional interest, which is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt will be convertible on such record date. Notwithstanding the foregoing, however, the interest payable on each interest payment date shall be the higher of (i) the Total Interest and (ii) 6.75% per annum. The note is convertible into the Company s common stock at the holder s option. The conversion price of $15.04 per share (approximately 66.4894 shares of common stock per $1,000 principal amount of the note) is subject to adjustment for various events, including the issuance of stock dividends. The note will mature on November 15, 2014. The Company will redeem on May 11, 2014 and at the end of each interest accrual period thereafter an additional amount, if any, of the note necessary to prevent the note from being treated as an Applicable High Yield Discount Obligation under the Internal Revenue Code. If a fundamental change (as defined in the note) occurs, the Company will be required to offer to repurchase the note at 100% of its principal amount, plus accrued interest.

The purchaser of the 6.75% Note is an entity affiliated with Dr. Phillip Frost, who reported, after the consummation of the sale, beneficial ownership of approximately 11.5% of the Company s common stock.

6.75% Variable Interest Senior Convertible Exchange Notes due 2014:

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In June 2009, the Company entered into agreements with certain holders of the 5% Notes to exchange their 5% notes for the Company s 6.75% Exchange Notes. On June 30, 2009, the Company accepted for exchange $99,944 principal amount of the 5% Notes for $106,940 of its 6.75% Exchange Notes. The Company issued its 6.75% Exchange Notes to the holders in reliance on the exemption from the registration requirements of the Securities Act of 1933, as amended, afforded by Section 3(a)(9) thereof. The notes pay interest (Total Interest) on a quarterly basis beginning August 15, 2009 at a rate of 3.75% per annum plus additional interest, which is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt will be convertible on such record date. Notwithstanding the foregoing, however, the interest payable on each interest payment date shall be the higher of (i) the Total Interest and (ii) 6.75% per annum. The notes are convertible into the Company s common stock at the holder s option. The conversion price of $17.06 per share (approximately 58.6063 shares of common stock per $1,000 principal amount of notes) is subject to adjustment for various events, including the issuance of stock dividends. The notes will mature on November 15, 2014. The Company will redeem on June 30, 2014 and at the end of each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an Applicable High Yield Discount Obligation under the Internal Revenue Code. If a fundamental change (as defined in the indenture) occurs, the Company will be required to offer to repurchase the notes at 100% of their principal amount, plus accrued interest and, under certain circumstances, a make whole payment.

Embedded Derivatives on the Variable Interest Senior Convertible Debt:

The portion of the interest on the Company s convertible debt which is computed by reference to the cash dividends paid on the Company s common stock is considered an embedded derivative within the convertible debt, which the Company is required to separately value. Pursuant to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities , the Company has bifurcated these embedded derivatives and estimated the fair value of the embedded derivative liability including using a third party valuation. The resulting discount created by allocating a portion of the issuance proceeds to the embedded derivative is then amortized to interest expense over the term of the debt using the effective interest method. Changes to the fair value of these embedded derivatives are reflected quarterly in the Company s consolidated statements of operations as Change in fair value of derivatives embedded within convertible debt. The value of the embedded derivative is contingent on changes in interest rates of debt instruments maturing over the duration of the convertible debt as well as projections of future cash and stock dividends over the term of the debt.

A summary of non-cash interest expense associated with the amortization of the debt discount created by the embedded derivative liability associated with the Company s variable interest senior convertible debt for the three and six months ended June 30, 2009 and 2008 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
6.75% Note	$ 70	$	$ 70	$
3.875% convertible debentures	113	90	225	180
5% convertible notes	1,712	1,293	3,369	2,481
Interest expense associated with embedded derivatives	$ 1,895	$ 1,383	$ 3,664	$ 2,661

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

A summary of non-cash changes in fair value of derivatives embedded within convertible debt is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
6.75% Note	$ (1,809)	$	$ (1,809)	$
3.875% convertible debentures	(15,577)	6,132	(17,329)	2,882
5% convertible notes	(2,102)	3,627	(653)	4,433
(Loss) gain on changes in fair value of derivatives embedded within convertible debt	$ (19,488)	$ 9,759	$ (19,791)	$ 7,315

The following table reconciles the fair value of derivatives embedded within convertible debt at June 30, 2009.

	6.75% Note	6.75% Exchange Notes	3.875% Convertible Debentures	5% Convertible Debentures	Total
Balance at December 31, 2008	$	$	$ 51,829	$ 25,416	$ 77,245
Loss (gain) from changes in fair value of embedded derivatives			1,752	(1,449)	303
Balance at March 31, 2009			53,581	23,967	77,548
Issuance of 6.75% Note	21,567			(2,485)	19,082
Issuance of 6.75% Exchange Notes		44,070		(23,392)	20,678
Loss from changes in fair value of embedded derivatives	1,809		15,577	2,102	19,488
Balance at June 30, 2009	$ 23,376	$ 44,070	$ 69,158	$ 192	$ 136,796

Beneficial Conversion Feature on Variable Interest Senior Convertible Debt:
After giving effect to the recording of the embedded derivative liability as a discount to the convertible debt, the Company s common stock had a fair value at the issuance date of the debt in excess of the conversion price resulting in a beneficial conversion feature. EITF Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Convertible Ratios , requires that the intrinsic value of the beneficial conversion feature be recorded to additional paid-in capital and as a discount on the debt. The discount is then amortized to interest expense over the term of the debt using the effective interest method.
In accordance with EITF Issue No. 05-8, the beneficial conversion feature has been recorded, net of income taxes, as an increase to stockholders equity.
A summary of non-cash interest expense associated with the amortization of the debt discount created by the beneficial conversion feature on the Company s variable interest senior convertible debt for the three and six months ended June 30, 2009 and 2008 is as follows:

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Amortization of beneficial conversion feature:				
6.75% Note	$ 60	$	$ 60	$
3.875% convertible debentures	(10)	(11)	(17)	(19)
5% convertible notes	951	717	1,870	1,373
Interest expense associated with beneficial conversion feature	$ 1,001	$ 706	$ 1,913	$ 1,354

Unamortized Debt Discount:

The following table reconciles unamortized debt discount at June 30, 2009:

	6.75% Note	6.75% Exchange Notes	3.875% Convertible Debentures	5% Convertible Notes	Total
Balance at December 31, 2008	$	$	$ 83,993	$ 39,565	$ 123,558
Amortization of embedded derivatives			(112)	(1,657)	(1,769)
Amortization of beneficial conversion feature			7	(919)	(912)
Balance at March 31, 2009			83,888	36,989	120,877
Issuance of convertible notes embedded derivative	21,567	44,070			65,637
Issuance of convertible notes beneficial conversion feature	18,808	27,222			46,688
Issuance of 6.75% Note write-off of unamortized debt discount				(3,311)	(3,311)
Issuance of 6.75% Exchange Notes write-off of unamortized debt discount				(30,745)	(30,745)
Amortization of embedded derivatives	(70)		(113)	(1,712)	(1,895)
Amortization of beneficial conversion feature	(60)		10	(951)	(1,001)
Balance at June 30, 2009	$ 40,245	$ 71,292	$ 83,785	$ 270	$ 196,250

Loss on Extinguishment of Debt:

The exchange of the 5% Notes for the 6.75% Notes and the 6.75% Exchange Notes qualifies as extinguishment of debt due to the significant change in terms. A summary of the Company s loss on the extinguishment of the 5% Notes for the three and six months ended June 30, 2009 is as follows:

	6.75% Note	6.75% Exchange Notes	Total
Issuance of additional notes payable	$ 770	$ 6,996	$ 7,766
Termination of embedded derivative	(2,485)	(23,392)	(25,877)
Write-off of deferred finance costs	257	2,242	2,499
Write-off of unamortized debt discount, net	3,311	30,745	34,056
Loss on extinguishment of debt	$ 1,853	$ 16,591	$ 18,444

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Revolving Credit Facility Liggett:

Liggett has a $50,000 credit facility with Wachovia Bank, N.A. under which $20,135 was outstanding at June 30, 2009. Availability as determined under the facility was approximately $16,843 based on eligible collateral at June 30, 2009.

Fair Value of Notes Payable and Long-term Debt:

The estimated fair value of the Company s notes payable and long-term debt has been determined by the Company using available market information and appropriate valuation methodologies described in Note 1. However, considerable judgment is required to develop the estimates of fair value and, accordingly, the estimate presented herein are not necessarily indicative of the amount that could be realized in a current market exchange.

	June 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Notes payable and long-term debt	$ 279,346	$ 466,442	$ 307,799	$ 447,520

Scheduled Maturities:

Scheduled maturities of long-term debt as of June 30, 2009 are as follows:

	Principal	Unamortized Discount	Net
Year Ending December 31:			
2009	$ 23,714	$ 270	$ 23,444
2010	4,425		4,425
2011	16,131	8,379	7,752
2012	103,211	75,406	27,805
2013	5,516		5,516
Thereafter	321,939	111,535	210,404
Total	$ 474,936	$ 195,590	$ 279,346

The scheduled maturities of $103,211 (principal amount) in 2012 reflect $99,000 (principal amount), which may be required to be redeemed in 2012 in accordance with the terms of its 3.875% Variable Interest Senior Convertible Debentures due 2026.

7. EMPLOYEE BENEFIT PLANS

Defined Benefit and Postretirement Plans:

Net periodic benefit cost for the Company s pension and other postretirement benefit plans for the three and six months ended June 30, 2009 and 2008 consists of the following:

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Pension Benefits			
	Three Months Ended		Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Service cost benefits earned during the period	$ 330	$ 1,035	$ 660	$ 2,070
Interest cost on projected benefit obligation	1,441	2,381	3,787	4,762
Expected return on plan assets	(1,954)	(3,036)	(3,908)	(6,072)
Amortization of prior service cost	200	350	400	700
Amortization of net loss	534	25	1,068	50
Net expense	$ 551	$ 755	$ 2,007	$ 1,510

	Other Postretirement Benefits			
	Three Months Ended		Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Service cost benefits earned during the period	$ 4	$ 4	$ 8	$ 8
Interest cost on projected benefit obligation	142	148	284	296
Amortization of net loss	(41)	(45)	(82)	(90)
Net expense	$ 105	$ 107	$ 210	$ 214

The decrease of $204 in the Company s pension expense for the three months ended June 30, 2009 was the result of increased defined benefit expense at the Liggett segment of approximately $1,600 due primarily to the amortization of losses experienced in 2008 on the investment portfolio underlying Liggett s defined benefit plans. The amount was offset by lower expenses of approximately $1,800 at the corporate segment due to the retirement of the Company s former Executive Chairman on December 30, 2008. The increase of $497 in the Company s pension expense for the six months ended June 30, 2009 was the result of increased defined benefit expense at the Liggett segment of approximately $3,200 due primarily to the amortization of losses experienced in 2008 on the investment portfolio underlying Liggett s defined benefit plans. The amount was offset by lower expenses of approximately $2,700 at the corporate segment due to the retirement of the Executive Chairman on December 30, 2008. The Company did not make contributions to its pension benefits plans for the three and six months ended June 30, 2009 and does not anticipate making any contributions to such plans in 2009. The Company anticipates paying approximately $750 in other postretirement benefits in 2009.

In connection with the retirement of the Executive Chairman, he received in July 2009 a payment of $20,860 under the terms of the Company s Supplemental Retirement Plan. The payment was partially funded by approximately $1,554 held in a separate trust.

8. CONTINGENCIES

Tobacco-Related Litigation:

Overview

Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in numerous direct, third-party and purported class actions predicated on the theory that cigarette manufacturers should be liable for damages alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. New cases continue to be commenced against Liggett and other cigarette manufacturers. The cases generally fall into the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs (Individual Actions); (ii) smoking and health cases primarily alleging personal injury or seeking court-supervised programs for ongoing medical monitoring, as well as cases alleging

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

the use of the terms lights and/or ultra lights constitutes a deceptive and unfair trade practice, common law fraud or violation of federal law, purporting to be brought on behalf of a class of individual plaintiffs (Class Actions); (iii) health care cost recovery actions brought by various foreign and domestic governmental entities (Governmental Actions); and (iv) health care cost recovery actions brought by third-party payors including insurance companies, union health and welfare trust funds, asbestos manufacturers and others (Third-Party Payor Actions). As new cases are commenced, the costs associated with defending these cases and the risks relating to the inherent unpredictability of litigation continue to increase. The future financial impact of the risks and expenses of litigation and the effects of the tobacco litigation settlements discussed below are not quantifiable at this time. Liggett incurred legal expenses and other litigation costs totaling approximately $2,960 and $3,069, for the six months ended June 30, 2009 and 2008 respectively.

Litigation is subject to uncertainty and it is possible that there could be adverse developments in pending or future cases. An unfavorable outcome or settlement of pending tobacco-related or other litigation could encourage the commencement of additional litigation. Damages claimed in some tobacco-related or other litigation are or can be significant.

Although Liggett has been able to obtain required bonds or relief from bonding requirements in order to prevent plaintiffs from seeking to collect judgments while adverse verdicts have been appealed, there remains a risk that such relief may not be obtainable in all cases. This risk has been substantially reduced given that 43 states now limit the dollar amount of bonds or require no bond at all. Liggett has secured approximately $2,950 in bonds as of June 30, 2009.

The Company and its subsidiaries record provisions in their consolidated financial statements for pending litigation when they determine that an unfavorable outcome is probable and the amount of loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, except as discussed elsewhere in this note: (i) management has concluded that it is not probable that a loss has been incurred in any of the pending tobacco-related cases; or (ii) management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome of any of the pending tobacco-related cases and, therefore, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any. Liggett believes, and has been so advised by counsel, that it has valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts. All such cases are, and will continue to be, vigorously defended. However, Liggett may enter into settlement discussions in particular cases if it believes it is in the best interest of the Company to do so.

Individual Actions

As of June 30, 2009, there were 35 individual cases pending against Liggett and/or the Company, where one or more individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to secondary smoke and seek compensatory and, in some cases, punitive damages. In addition, there were approximately 3,200 *Engle* progeny cases (defined below) pending against Liggett and/or the Company, in state and federal courts in Florida, and approximately 100 individual cases pending in West Virginia state court as part of a consolidated action. The following table lists the number of individual cases by state that are pending against Liggett or its affiliates as of June 30, 2009 (excluding *Engle* progeny cases and the cases consolidated in West Virginia):

State	Number of Cases
Florida	14
New York	10

Louisiana	5
West Virginia	2
Mississippi	1
Maryland	1
Missouri	1
Ohio	1

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Liggett Only Cases. There are currently six cases pending where Liggett is the only tobacco company defendant. In April 2004, in *Davis v. Liggett Group,* a Florida state court jury awarded compensatory damages of $540 against Liggett, plus interest. In addition, the court awarded plaintiff s counsel legal fees of $752. Liggett appealed both the compensatory and the legal fee awards. In October 2007, the compensatory award was affirmed by the Fourth District Court of Appeal and, thereafter, was paid by Liggett. In March 2008, the Fourth District Court of Appeal reversed and remanded the legal fee award for further proceedings in the trial court. The Company has accrued approximately $1,499 for plaintiff s claim for attorneys fees and costs. *In Ferlanti v. Liggett Group*, in February 2009, a Florida state court jury awarded compensatory damages of $1,200 against Liggett, but found that the plaintiff was 40% at fault. Therefore, plaintiff was awarded $720 in compensatory damages plus $96 in expenses. Liggett has appealed the award. Punitive damages were not awared. On May 1, 2009, the court granted plaintiff s motion for an award of attorneys fees but the amount has not yet been determined. In *Hausrath v. Philip Morris*, a case pending in New York state court, plaintiffs recently dismissed all defendants other than Liggett. The other three individual actions, where Liggett is the only tobacco company defendant, are dormant.

The plaintiffs allegations of liability in those cases in which individuals seek recovery for injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, breach of special duty, strict liability, fraud, concealment, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, property damage, invasion of privacy, mental anguish, emotional distress, disability, shock, indemnity and violations of deceptive trade practice laws, the federal Racketeer Influenced and Corrupt Organizations Act (RICO), state RICO statutes and antitrust statutes. In many of these cases, in addition to compensatory damages, plaintiffs also seek other forms of relief including treble/multiple damages, medical monitoring, disgorgement of profits and punitive damages. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from state to state and jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses raised by defendants in individual cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statute of limitations, equitable defenses such as unclean hands and lack of benefit, failure to state a claim and federal preemption.

In addition to the awards against Liggett in *Davis* and *Ferlanti* (described above), jury awards in individual cases have also been returned against other cigarette manufacturers in recent years. The awards in these individual actions, often in excess of millions of dollars, are for both compensatory and punitive damages. There are several significant jury awards against other cigarette manufacturers which are currently on appeal.

Engle Progeny Cases. In 2000, a jury in *Engle v. R.J. Reynolds Tobacco Co.* rendered a $145,000,000 punitive damages verdict in favor of a Florida Class against certain cigarette manufacturers, including Liggett. Pursuant to the Florida Supreme Court s July 2006 ruling in *Engle*, which decertified the class on a prospective basis, and affirmed the appellate court s reversal of the punitive damages award, former class members had one year from January 11, 2007 in which to file individual lawsuits. In addition, some individuals who filed suit prior to January 11, 2007, and who claim they meet the conditions in *Engle*, are attempting to avail themselves of the *Engle* ruling. Lawsuits by individuals requesting the benefit of the *Engle* ruling, whether filed before or after the January 11, 2007 deadline, are referred to as the *Engle* progeny cases. Liggett and/or the Company have been named in approximately 3,200 *Engle* progeny cases in both state and federal courts in Florida. Other cigarette manufacturers have also been named as defendants in most of these cases. These cases include approximately 8,750 plaintiffs, approximately 3,200 of whom have claims pending in federal court. Duplicate cases were filed in federal and state court on behalf of approximately 660 plaintiffs. The

majority of the cases pending in federal court are stayed pending the outcome of an appeal to the United States Court of Appeals for the Eleventh Circuit

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

of several district court orders in which it was found that the Florida Supreme Court s decision in *Engle* was unconstitutional. The number of cases will likely increase as the courts may require multi-plaintiff cases to be severed into individual cases. The total number of plaintiffs may also increase as a result of attempts by existing plaintiffs to add additional parties. There are approximately 54 *Engle* progeny cases currently scheduled for trial, or likely to be scheduled for trial, in 2009 and 2010. To date, six *Engle* progeny cases have been tried against other cigarette manufacturers resulting in four plaintiff verdicts and two defense verdicts. For further information on the *Engle* case and on *Engle* progeny cases, see Class Actions *Engle* Case, below.

Class Actions

As of June 30, 2009, there were seven actions pending for which either a class had been certified or plaintiffs were seeking class certification, where Liggett is a named defendant, including one alleged price fixing case. Other cigarette manufacturers are also named in these actions. Many of these actions purport to constitute statewide class actions and were filed after May 1996 when the United States Court of Appeals for the Fifth Circuit, in *Castano v. American Tobacco Co.*, *Inc.*, reversed a federal district court s certification of a purported nationwide class action on behalf of persons who were allegedly addicted to tobacco products.

Plaintiff s allegations of liability in class action cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, nuisance, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, violation of deceptive trade practice laws and consumer protection statutes and claims under the federal and state anti-racketeering statutes. Plaintiffs in the class actions seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and equitable relief. Defenses raised in these cases include, among others, lack of proximate cause, individual issues predominate, assumption of the risk, comparative fault and/or contributory negligence, statutes of limitations and preemption by the Federal Cigarette Labeling and Advertising Act.

Engle Case. In May 1994, *Engle* was filed against Liggett and others in Miami-Dade County, Florida. The class consisted of all Florida residents who, by November 21, 1996, have suffered, presently suffer or have died from diseases and medical conditions caused by their addiction to cigarette smoking. In July 1999, after the conclusion of Phase I of the trial, the jury returned a verdict against Liggett and other cigarette manufacturers on certain issues determined by the trial court to be common to the causes of action of the plaintiff class. The jury made several findings adverse to the defendants including that defendants conduct rose to a level that would permit a potential award or entitlement to punitive damages. Phase II of the trial was a causation and damages trial for three of the class plaintiffs and a punitive damages trial on a class-wide basis, before the same jury that returned the verdict in Phase I. In April 2000, the jury awarded compensatory damages of $12,704 to the three class plaintiffs, to be reduced in proportion to the respective plaintiff s fault. In July 2000, the jury awarded approximately $145,000,000 in punitive damages, including $790,000 against Liggett.

In May 2003, Florida s Third District Court of Appeal reversed the trial court and remanded the case with instructions to decertify the class. The judgment in favor of one of the three class plaintiffs, in the amount of $5,831, was overturned as time barred and the court found that Liggett was not liable to the other two class plaintiffs.

In July 2006, the Florida Supreme Court affirmed the decision vacating the punitive damages award and held that the class should be decertified prospectively, but preserved several of the trial court s Phase I findings, including that: (i) smoking causes lung cancer, among other diseases; (ii) nicotine in cigarettes is addictive; (iii) defendants placed cigarettes on the market that were defective and unreasonably dangerous; (iv) defendants concealed material information knowing that the information was false or misleading or failed to disclose a material fact

concerning the health effects or addictive nature of smoking; (v) defendants agreed to conceal or omit information regarding the health effects of cigarettes or their addictive nature with the intention that smokers would rely on the information to their detriment; (vi) defendants sold or supplied cigarettes that were defective; and (vii) defendants

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

were negligent. The Florida Supreme Court decision also allowed former class members to proceed to trial on individual liability issues (using the above findings) and compensatory and punitive damage issues, provided they file their individual lawsuits by January 2008. In December 2006, the Florida Supreme Court added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply, did not conform to the representations made by defendants. As a result of the decision, approximately 8,750 former *Engle* class members filed suit against the Company and/or Liggett as well as other cigarette manufacturers.

Three federal district courts (in the *Merlob, Brown* and *Burr* cases) have ruled that the findings in the first phase of the *Engle* proceedings cannot be used to satisfy elements of plaintiffs claims, and two of those rulings (*Brown* and *Burr*) have been certified by the trial court for interlocutory review. The certification in both cases has been granted by the United States Court of Appeals for the Eleventh Circuit and the appeals have been consolidated. In February 2009, the appeal in *Burr* was dismissed for lack of prosecution. *Engle* progeny cases pending in the federal district courts in the Middle District of Florida have been stayed pending interlocutory review by the Eleventh Circuit. Several state trial court judges have issued contrary rulings that allowed plaintiffs to use the *Engle* findings to establish elements of their claims and required certain defenses to be stricken.

In June 2002, the jury in a Florida state court action entitled *Lukacs v. R.J. Reynolds Tobacco Co.,* awarded $37,500 in compensatory damages, jointly and severally, in a case involving Liggett and two other cigarette manufacturers, which amount was subsequently reduced by the court. The jury found Liggett 50% responsible for the damages incurred by the plaintiff. The *Lukacs* case was the first case to be tried as an individual *Engle* progeny case, but was tried almost five years prior to the Florida Supreme Court s final decision in *Engle*. In November 2008, the court entered final judgment in the amount of $24,835 (for which Liggett is 50% responsible), plus interest from June 2002 which, as of June 30, 2009, was in excess of $13,000. Defendants filed a notice of appeal in December 2008 and have posted supersedeas bonds. Briefing is underway. In addition, plaintiff filed a motion seeking an award of attorneys fees from Liggett based on plaintiff s prior proposal for settlement. All proceedings relating to the motion for attorneys fees are stayed pending a final resolution of appellate proceedings.

Other Class Actions. Smith v. Philip Morris, a Kansas state court case, is an action in which plaintiffs allege that cigarette manufacturers conspired to fix cigarette prices in violation of antitrust laws. Class certification was granted in *Smith* in November 2001. Discovery is ongoing.

Class action suits have been filed in a number of states against cigarette manufacturers, alleging, among other things, that use of the terms light and ultra light constitutes unfair and deceptive trade practices, among other things. One such suit, *Schwab [McLaughlin] v. Philip Morris,* pending in federal court in New York since 2004, sought to create a nationwide class of light cigarette smokers. In September 2006, the United States District Court for the Eastern District of New York certified the class. In April 2008, the United States Court of Appeals for the Second Circuit decertified the class. The case was returned to the trial court for further proceedings (see discussion of *Cleary* case below). In December 2008, the United States Supreme Court, in *Altria Group Inc. v. Good*, ruled that the Federal Cigarette Labeling and Advertising Act did not preempt the state law claims asserted by the plaintiffs and that they could proceed with their claims under the Maine Unfair Trade Practices Act. This ruling may result in additional class action cases in other states. Although Liggett is not a party in the *Good* case, an adverse ruling or commencement of additional lights related class actions could have a material adverse effect on the Company.

In November 1997, in *Young v. American Tobacco Co.,* a purported personal injury class action was commenced on behalf of plaintiff and all similarly situated residents in Louisiana who, though not themselves cigarette smokers, are alleged to have been exposed to secondhand smoke from cigarettes which were manufactured by the defendants, and who suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In October 2004, the trial court stayed this case pending the

outcome of the appeal in *Scott v. American Tobacco Co.* (see description below).

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In June 1998, in *Cleary v. Philip Morris,* a putative class action was brought in Illinois state court on behalf of persons who were allegedly injured by: (i) defendants purported conspiracy to conceal material facts regarding the addictive nature of nicotine; (ii) defendants alleged acts of targeting their advertising and marketing to minors; and (iii) defendants claimed breach of the public s right to defendants compliance with laws prohibiting the distribution of cigarettes to minors. Plaintiffs request that defendants be required to disgorge all profits unjustly received through their sale of cigarettes to plaintiffs and the class. In July 2006, the plaintiffs filed a motion for class certification. A class certification hearing occurred in September 2007 and the parties are awaiting a decision. Merits discovery is stayed pending a ruling by the court. In March 2009, plaintiffs filed a third amended complaint adding, among other things, allegations regarding defendants sale of light cigarettes. In April 2009, plaintiffs in 11 lights class actions, including *Cleary* and *Schwab,* moved to consolidate pretrial proceedings in these 11 cases in the United States District Court for the Eastern District of New York, or alternatively, the Southern District of Florida, in a Multidistrict Litigation. Oral argument was heard on July 30, 2009.

In April 2001, in *Brown v. American Tobacco Co.,* a California state court granted in part plaintiffs motion for class certification and certified a class comprised of adult residents of California who smoked at least one of defendants cigarettes during the applicable time period and who were exposed to defendants marketing and advertising activities in California. In March 2005, the court granted defendants motion to decertify the class based on a recent change in California law. In June 2009, the California Supreme Court reversed and remanded. The defendants moved for rehearing of that decision. A decision is expected in August 2009.

Although not technically a class action, in *Re: Tobacco Litigation (Personal Injury Cases)*, a West Virginia state court consolidated approximately 750 individual smoker actions that were pending prior to 2001 for trial of certain common issues. In January 2002, the court severed Liggett from the trial of the consolidated action. The consolidation was affirmed on appeal by the West Virginia Supreme Court. In February 2008, the United States Supreme Court denied defendants petition for writ of certiorari asking the Court to review the trial plan. If the case eventually proceeds against Liggett, it is estimated that Liggett could be a defendant in approximately 100 of the individual cases.

Class certification motions are pending in a number of other cases and a number of orders denying class certification are on appeal. In addition to the cases described above, numerous class actions remain certified against other cigarette manufacturers, including *Scott.* In that case, a Louisiana jury returned a $591,000 verdict (subsequently reduced by the court to $263,500 plus interest from June 2004) against other cigarette manufacturers to fund medical monitoring or smoking cessation programs for members of the class. The case is on appeal.

Governmental Actions

As of June 30, 2009, there is one active Governmental Action pending against Liggett. The claims asserted in health care cost recovery actions vary. In these cases, the governmental entities typically assert equitable claims that the tobacco industry was unjustly enriched by their payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, breach of special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

In *City of St. Louis v. American Tobacco Company*, a case pending in Missouri state court since December 1998, the City of St. Louis and approximately 40 hospitals seek recovery of costs expended by the hospitals on behalf of patients who suffer, or have suffered, from illnesses allegedly resulting from the use of cigarettes. In

June 2005, the court granted defendants motion for summary judgment as to claims for damages which accrued prior to November 16, 1993. The claims for damages which accrued after November 16, 1993 are pending. Discovery is

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

ongoing. In September 2008, the court heard argument on motions for summary judgment filed by the parties. A decision is pending. Trial is currently scheduled to commence in January 2010.

DOJ Case. In September 1999, the United States government commenced litigation against Liggett and other cigarette manufacturers in the United States District Court for the District of Columbia. The action sought to recover an unspecified amount of health care costs paid and to be paid by the federal government for lung cancer, heart disease, emphysema and other smoking-related illnesses allegedly caused by the fraudulent and tortious conduct of defendants, to restrain defendants and co-conspirators from engaging in alleged fraud and other allegedly unlawful conduct in the future, and to compel defendants to disgorge the proceeds of their unlawful conduct. The action asserted claims under three federal statutes, the Medical Care Recovery Act (MCRA), the Medicare Secondary Payer provisions of the Social Security Act (MSP) and RICO. In September 2000, the court dismissed the government s claims based on MCRA and MSP.

In August 2006, the trial court entered a Final Judgment and Remedial Order against each of the cigarette manufacturing defendants, except Liggett. The Final Judgment, among other things, enjoined the non-Liggett defendants from using lights , low tar , ultra lights , mild , or natural descriptors, or conveying any other expre implied health messages in connection with the marketing or sale of cigarettes. The Final Judgment was stayed pending appeal. In May 2009, the United States Court of Appeals for the District of Columbia Circuit affirmed most of the district court s decision. The other cigarette manufacturers have indicated that they will seek an appeal to the United States Supreme Court. Although this case has been concluded as to Liggett, it is unclear what impact, if any, the Final Judgment will have on the cigarette industry as a whole. To the extent that the Final Judgment leads to a decline in industry-wide shipments of cigarettes in the United States or otherwise results in restrictions that adversely affect the industry, Liggett s sales volume, operating income and cash flows could be materially adversely affected.

Third-Party Payor Actions

As of June 30, 2009, there were two Third-Party Payor Actions pending against Liggett and other cigarette manufacturers. Third-Party Payor Actions typically have been filed by insurance companies, union health and welfare trust funds, asbestos manufacturers and others. In Third-Party Payor Actions, plaintiffs seek damages for funding of corrective public education campaigns relating to issues of smoking and health; funding for clinical smoking cessation programs; disgorgement of profits from sales of cigarettes; restitution; treble damages; and attorneys fees. Although no specific amounts are provided, it is possible that requested damages against cigarette manufacturers in these cases might be in the billions of dollars.

Several federal circuit courts of appeals and state appellate courts have ruled that Third-Party Payors do not have standing to bring lawsuits against cigarette manufacturers, relying primarily on grounds that plaintiffs claims were too remote. The United States Supreme Court has refused to consider plaintiffs appeals from the cases decided by five federal circuit courts of appeals.

In June 2005, the Jerusalem District Court in Israel added Liggett as a defendant in an action commenced in 1998 by the largest private insurer in that country, General Health Services, against the major United States cigarette manufacturers. The plaintiff seeks to recover the past and future value of the total expenditures for health care services provided to residents of Israel resulting from tobacco related diseases, court ordered interest for past expenditures from the date of filing the statement of claim, increased and/or punitive and/or exemplary damages and costs. The court ruled that, although Liggett had not sold product in Israel since at least 1978, it might still have liability for cigarettes sold prior to that time. Motions filed by defendants are pending before the Israel Supreme Court seeking appeal from a lower court s decision granting leave to plaintiff for foreign service of process.

In May 2008, in *National Committee to Preserve Social Security and Medicare v. Philip Morris USA,* a case pending in the United States District Court for the Eastern District of New York, plaintiffs commenced an action to

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

recover twice the amount paid by Medicare for the health care services provided to Medicare beneficiaries to treat diseases allegedly attributable to smoking defendants cigarettes from May 21, 2002 to the present, for which treatment defendants allegedly were required to make payment under MSP. Defendants Motion to Dismiss and plaintiffs Motion for Partial Summary Judgment were filed in July 2008 and in March 2009, the court dismissed the case. Plaintiffs appealed the decision.

Upcoming Trials

There are currently approximately 54 *Engle* progeny cases that may be set for trial during 2009 and 2010. The Company and/or Liggett and other cigarette manufacturers are currently named as defendants in each of these cases. Trial dates are subject to change.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

MSA and Other State Settlement Agreements

In March 1996, March 1997 and March 1998, Liggett entered into settlements of smoking-related litigation with 45 states and territories. The settlements released Liggett from all smoking-related claims within those states and territories, including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors.

In November 1998, Philip Morris, Brown & Williamson, R.J. Reynolds and Lorillard (the Original Participating Manufacturers or OPMs) and Liggett (together with any other tobacco product manufacturer that becomes a signatory, the Subsequent Participating Manufacturers or SPMs) (the OPMs and SPMs are hereinafter referred to jointly as the Participating Manufacturers) entered into the Master Settlement Agreement (the MSA) with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Mariana Islands (collectively, the Settling States) to settle the asserted and unasserted health care cost recovery and certain other claims of the Settling States. The MSA received final judicial approval in each Settling State.

As a result of the MSA, the Settling States released Liggett from:

- all claims of the Settling States and their respective political subdivisions and other recipients of state health care funds, relating to: (i) past conduct arising out of the use, sale, distribution, manufacture, development, advertising and marketing of tobacco products; (ii) the health effects of, the exposure to, or research, statements or warnings about, tobacco products; and
- all monetary claims of the Settling States and their respective subdivisions and other recipients of state health care funds relating to future conduct arising out of the use of, or exposure to, tobacco products that have been manufactured in the ordinary course of business.

The MSA restricts tobacco product advertising and marketing within the Settling States and otherwise restricts the activities of Participating Manufacturers. Among other things, the MSA prohibits the targeting of youth in the advertising, promotion or marketing of tobacco products; bans the use of cartoon characters in all tobacco advertising and promotion; limits each Participating Manufacturer to one tobacco brand name sponsorship during any 12-month period; bans all outdoor advertising, with certain limited exceptions; prohibits payments for tobacco product placement in various media; bans gift offers based on the purchase of tobacco products without sufficient proof that the intended recipient is an adult; prohibits Participating Manufacturers from licensing third parties to advertise tobacco brand names in any manner prohibited under the MSA; and prohibits Participating Manufacturers from using as a tobacco product brand name any nationally recognized non-tobacco brand or trade name or the names of sports teams, entertainment groups or individual celebrities.

The MSA also requires Participating Manufacturers to affirm corporate principles to comply with the MSA and to reduce underage use of tobacco products and imposes restrictions on lobbying activities conducted on behalf of Participating Manufacturers. In addition, the MSA provides for the appointment of an independent auditor to calculate and determine the amounts of payments owed pursuant to the MSA.

Liggett has no payment obligations under the MSA except to the extent its market share exceeds a market share exemption of approximately 1.65% of total cigarettes sold in the United States. Vector Tobacco has no payment obligations under the MSA, except to the extent its market share exceeds a market share exemption of approximately 0.28% of total cigarettes sold in the United States. According to data from Management Science Associates, Inc., domestic shipments by Liggett and Vector Tobacco accounted for approximately 2.4%, 2.5% and 2.5% of the total cigarettes shipped in the United States in 2006, 2007 and 2008 respectively. If Liggett s or Vector Tobacco s market share exceeds their respective market share exemption in a given year, then on April 15 of the following year, Liggett and/or Vector

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Tobacco, as the case may be, must pay on each excess unit an amount equal (on a per-unit basis) to that due from the OPMs for that year. In April 2007, Liggett and Vector Tobacco paid $38,743 for their 2006 MSA obligations and in April 2008, paid $35,995 for their 2007 MSA obligations, having prepaid $34,500 of that amount in December 2007. In December 2008, Liggett and Vector Tobacco prepaid $34,000 of their 2008 MSA obligations and paid an additional $8,799 in April 2009 after withholding certain disputed amounts.

Under the payment provisions of the MSA, the Participating Manufacturers are required to pay a base annual amount of $9,000,000 in 2009 and each year thereafter (subject to applicable adjustments, offsets and reductions). These annual payments are allocated based on unit volume of domestic cigarette shipments. The payment obligations under the MSA are the several, and not joint, obligations of each Participating Manufacturer and are not the responsibility of any parent or affiliate of a Participating Manufacturer.

Certain MSA Disputes

In 2005, the independent auditor under the MSA calculated that Liggett owed $28,668 for its 2004 sales. In April 2005, Liggett paid $11,678 and disputed the balance, as permitted by the MSA. Liggett subsequently paid $9,304 of the disputed amount, although Liggett continues to dispute that this amount is owed. This $9,304 relates to an adjustment to its 2003 payment obligation claimed by Liggett for the market share loss to non-participating manufacturers, which is known as the NPM Adjustment. At June 30, 2009, included in Other assets on the Company s consolidated balance sheet, was a noncurrent receivable of $6,513 relating to such amount. The remaining balance in dispute of $7,686 is comprised of $5,318 claimed for a 2004 NPM Adjustment and $2,368 relating to the independent auditor s retroactive change from gross to net units in calculating MSA payments, which Liggett contends is improper, as discussed below. From their April 2006 payment, Liggett and Vector Tobacco withheld approximately $1,600 claimed for the 2005 NPM Adjustment and $2,949 relating to the retroactive change from gross to net units. Liggett and Vector Tobacco withheld approximately $4,200 from their April 2007 payments related to the 2006 NPM Adjustment and approximately $3,950 relating to the retroactive change from gross to net units. From their April 2008 payment, Liggett and Vector Tobacco withheld approximately $4,000 for the 2007 NPM Adjustment and approximately $3,696 relating to the retroactive change from gross to net units. Vector Tobacco paid approximately $200 into the disputed payments account for the 2007 NPM Adjustment. From their April 2009 payment, Liggett and Vector Tobacco withheld approximately $6,100 relating to the 2008 NPM adjustment and approximately $3,300 relating to the retroactive change from gross to net units.

The following amounts have not previously been expensed by the Company as they relate to Liggett s and Vector Tobacco s claim for an NPM adjustment: $6,513 for 2003, $3,789 for 2004 and $800 for 2005.

NPM Adjustment. In March 2006, an economic consulting firm selected pursuant to the MSA rendered its final and non-appealable decision that the MSA was a significant factor contributing to the loss of market share of Participating Manufacturers for 2003. The economic consulting firm subsequently rendered the same decision with respect to 2004, 2005 and 2006. As a result, the manufacturers are entitled to potential NPM Adjustments to their 2003, 2004, 2005 and 2006 MSA payments. A Settling State that has diligently enforced its qualifying escrow statute in the year in question may be able to avoid application of the NPM Adjustment to the payments made by the manufacturers for the benefit of that state or territory.

Since April 2006, notwithstanding provisions in the MSA requiring arbitration, litigation has been filed in 49 Settling States over the issue of whether the application of the NPM Adjustment for 2003 is to be determined through litigation or arbitration. These actions relate to the potential NPM Adjustment for 2003, which the independent auditor under the MSA previously determined to be as much as $1,200,000 for all Participating Manufacturers. All 48 courts that have decided the issue have ruled that the 2003 NPM Adjustment dispute is arbitrable and 47 of those decisions are final and non-appealable. In response to a proposal from the OPMs and

many of the SPMs, 45 of the Settling States, representing approximately 90% of the allocable share of the Settling States, entered into an agreement providing for a nationwide arbitration of the dispute with respect to the NPM Adjustment for 2003. The agreement provides for selection of the arbitration panel beginning October 1, 2009 and that the parties and the arbitrators will thereafter establish the schedule and procedures for the arbitration. Because states representing more than 80% of the allocable share signed the agreement, signing

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

states will receive a 20% reduction of any potential 2003 NPM adjustment. It is anticipated that the arbitration will begin in 2010. There can be no assurance that Liggett or Vector Tobacco will receive any adjustment as a result of these proceedings.

Gross v. Net Calculations. In October 2004, the independent auditor notified Liggett and all other Participating Manufacturers that their payment obligations under the MSA, dating from the agreement s execution in late 1998, had been recalculated using net unit amounts, rather than gross unit amounts (which had been used since 1999). The change in the method of calculation could, among other things, require additional MSA payments by Liggett of approximately $25,900, including interest, for 2001 through 2008, and require additional amounts in future periods because the proposed change from gross to net units would serve to lower Liggett s market share exemption under the MSA.

Liggett has objected to this retroactive change and has disputed the change in methodology. Liggett contends that the retroactive change from using gross to net unit amounts is impermissible for several reasons, including:

- use of net unit amounts is not required by the MSA (as reflected by, among other things, the use of gross unit amounts through 2005);
- such a change is not authorized without the consent of affected parties to the MSA;
- the MSA provides for four-year time limitation periods for revisiting calculations and determinations, which precludes recalculating Liggett s 1997 Market Share (and thus, Liggett s market share exemption); and
- Liggett and others have relied upon the calculations based on gross unit amounts since 1998.

No amounts have been expensed or accrued in the accompanying consolidated financial statements for any potential liability relating to the gross versus net dispute.

QUEST 3. Vector Tobacco has not made MSA payments on sales of its QUEST 3 product as Vector Tobacco believes that QUEST 3 does not fall within the definition of a cigarette under the MSA. Quest is no longer being sold by Vector Tobacco. There can be no assurance that additional payments under the MSA for QUEST 3 will not be owed.

Litigation Challenging the MSA. In *Freedom Holdings Inc. v. Cuomo*, litigation pending in federal court in New York, certain importers of cigarettes allege that the MSA and certain related New York statutes violate federal antitrust and constitutional law. The district court granted New York s motion to dismiss the complaint for failure to state a claim. On appeal, the United States Court of Appeals for the Second Circuit held that if all of the allegations of the complaint were assumed to be true, plaintiffs had stated a claim for relief on antitrust grounds. In January 2009, the district court granted New York s motion for summary judgment, dismissing all claims brought by the plaintiffs, and dissolving the preliminary injunction. The plaintiffs have appealed.

In *Grand River Enterprises Six Nations, Ltd. v. Pryor*, another proceeding pending in federal court in New York, plaintiffs seek to enjoin the statutes enacted by New York and other states in connection with the MSA on the grounds that the statutes violate the Commerce Clause of the United States Constitution and federal antitrust laws. In September 2005, the United States Court of Appeals for the Second Circuit held that if all of the allegations of the complaint were assumed to be true, plaintiffs had stated a claim for relief and that the New York federal court had jurisdiction over the other defendant states. On remand, the trial court held that plaintiffs are unlikely to succeed on the merits. Discovery is pending. Similar challenges to the MSA and MSA-related state statutes are pending in Kentucky, Arkansas, Kansas, Louisiana, Tennessee and Oklahoma. Liggett and the other

Table of Contents

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

cigarette manufacturers are not defendants in these cases. Litigation challenging the validity of the MSA, including claims that the MSA violates antitrust laws, has not been successful to date.

(4,141)

Proceeds from sale of student loans	634	2,455
Purchase of additional business units	--	(730)
Purchase of premises and equipment	(3,992)	(2,642)
Proceeds from sale of premises and equipment	413	65
Proceeds from sale of foreclosed assets	8,065	1,810
Capitalized costs on foreclosed assets	(394)	(94)
Proceeds from sales of available-for-sale investment securities	85,242	1,664
Proceeds from maturing available-for-sale investment securities	21,000	391,335
Proceeds from maturing held-to-maturity investment securities	60	50
Proceeds from called investment securities	120,500	6,850
Principal reductions on mortgage-backed securities	48,937	56,805
Purchase of available-for-sale securities	(371,034)	(511,729)
(Purchase) redemption of Federal Home Loan Bank stock	5,109	(1,062)
Net cash used in investing activities	(110,515)	(173,129)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in certificates of deposit	205,078	(13,331)
Net increase (decrease) in checking and savings deposits	(106,985)	90,167
Proceeds from Federal Home Loan Bank advances	503,000	749,000
Repayments of Federal Home Loan Bank advances	(594,020)	(734,097)
Net increase in short-term borrowings and structured repo	115,072	55,732
Advances from borrowers for taxes and insurance	854	864
Proceeds from issuance of trust preferred debentures	--	5,155
Stock repurchase	(408)	(6,036)
Dividends paid	(7,227)	(6,685)
Stock options exercised	376	1,353
Net cash provided by financing activities	115,740	142,122
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	42,503	(12,214)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	80,525	133,150
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 123,028	$ 120,936

See Notes to Consolidated Financial Statements

4

GREAT SOUTHERN BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements of Great Southern Bancorp, Inc. (the "Company" or "Great Southern") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The financial statements presented herein reflect all adjustments which are, in the opinion of management, necessary to fairly present the financial position, results of operations and cash flows of the Company for the periods presented. Those adjustments consist only of normal recurring adjustments. Operating results for the three and nine months ended September 30, 2008 and 2007 are not necessarily indicative of the results that may be expected for the full year. The consolidated statement of financial condition of the Company as of December 31, 2007, has been derived from the audited consolidated statement of financial condition of the Company as of that date.

Certain information and note disclosures normally included in the Company's annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for 2007 filed with the Securities and Exchange Commission.

NOTE 2: OPERATING SEGMENTS

The Company's banking operation is its only reportable segment. The banking operation is principally engaged in the business of originating residential and commercial real estate loans, construction loans, commercial business loans and consumer loans and funding these loans through deposits attracted from the general public and correspondent account relationships, brokered deposits and borrowings from the Federal Home Loan Bank ("FHLBank") and others. The operating results of this segment are regularly reviewed by management to make decisions about resource allocations and to assess performance.

Revenue from segments below the reportable segment threshold is attributable to three operating segments of the Company. These segments include insurance services, travel services and investment services. Selected information is not presented separately for the Company's reportable segment, as there is no material difference between that information and the corresponding information in the consolidated financial statements.

For the three months ended September 30, 2008, the travel, insurance and investment divisions reported gross revenues of $1.3 million, $377,000 and $264,000, respectively, and net income (loss) of $(110,000), $39,000 and $115,000, respectively. For the three months ended September 30, 2007, the travel, insurance and investment divisions reported gross revenues of $1.7 million, $442,000 and $454,000, respectively, and net income (loss) of $(52,000), $46,000 and $92,000, respectively.

For the nine months ended September 30, 2008, the travel, insurance and investment divisions reported gross revenues of $5.0 million, $1.1 million and $1.0 million, respectively, and net income of $77,000, $129,000 and $259,000, respectively. For the nine months ended September 30, 2007, the travel, insurance and investment divisions reported gross revenues of $5.2 million, $1.2 million and $1.5 million, respectively, and net income of $284,000, $145,000 and $144,000, respectively.

The decrease in gross revenues in the investment division for the three and nine months ended September 30, 2008, was a result of the alliance formed with Ameriprise Financial Services through Penney, Murray and Associates. As a result of this change, Great Southern now records most of its investment services activity on a net basis in non-interest income. Thus, non-interest expense related to the investment services division is also reduced.

NOTE 3: COMPREHENSIVE INCOME

Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, requires the reporting of comprehensive income and its components. Comprehensive income is defined as the change in equity from transactions and other events and circumstances from non-owner sources, and excludes investments by and distributions to owners. Comprehensive income includes net income and other items of comprehensive income meeting the above criteria. The Company's only component of other comprehensive income is the unrealized gains and losses on available-for-sale securities.

	Three Months Ended September 30,			
	2008		2007	
	(In thousands)			
Net income	$	824	$	7,317
Unrealized holding gains (losses), net of income taxes		(5,274)		1,556
Less: reclassification adjustment for gains (losses) included in net income, net of income taxes		(3,440)		3
		(1,834)		1,553
Comprehensive income (loss)	$	(1,010)	$	8,870

	Nine Months Ended September 30,			
	2008		2007	
	(In thousands)			
Net income (loss)	$	(7,997)	$	22,860
Unrealized holding gains (losses), net of income taxes		(9,270)		(719)
Less: reclassification adjustment for gains (losses) included in net income, net of income taxes		(3,436)		3
		(5,834)		(722)
Comprehensive income (loss)	$	(13,831)	$	22,138

6

NOTE 4: RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141 (revised), Business Combinations. SFAS No. 141(revised) retains the fundamental requirements in Statement 141 that the acquisition method of accounting be used for business combinations, but broadens the scope of Statement 141 and contains improvements to the application of this method. The Statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Costs incurred to effect the acquisition are to be recognized separately from the acquisition. Assets and liabilities arising from contractual contingencies must be measured at fair value as of the acquisition date. Contingent consideration must also be measured at fair value as of the acquisition date. SFAS No. 141 (revised) applies to business combinations occurring after January 1, 2009. Based on its current activities, the Company does not expect the adoption of this Statement will have a material effect on the Company's financial position or results of operations.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements—an Amendment of ARB No. 51. SFAS No. 160 requires that a noncontrolling interest in a subsidiary be accounted for as equity in the consolidated statement of financial position and that net income include the amounts for both the parent and the noncontrolling interest, with a separate amount presented in the income statement for the noncontrolling interest share of net income. SFAS No. 160 also expands the disclosure requirements and provides guidance on how to account for changes in the ownership interest of a subsidiary. SFAS No. 160 is effective for the Company on January 1, 2009. Based on its current activities, the Company does not expect the adoption of this Statement will have a material effect on the Company's financial position or results of operations.

In February 2008, the FASB issued FASB Staff Position No. 157-2. The staff position delays the effective date of SFAS No. 157, Fair Value Measurements (which was adopted by the Company on January 1, 2008) for nonfinancial assets and liabilities on a recurring basis, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The delay is intended to allow additional time to consider the effect of various implementation issues with regard to the application of SFAS No. 157. This staff position defers the effective date of SFAS No. 157 to January 1, 2009, for items within the scope of the staff position.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133, which requires enhanced disclosures about an entity's derivative and hedging activities intended to improve the transparency of financial reporting. Under SFAS No. 161, entities will be required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company expects to adopt SFAS No. 161 effective January 1, 2009. The adoption of this standard is not anticipated to have a material effect on the Company's financial position or results of operations.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and the framework for

selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States (the GAAP hierarchy). The FASB concluded that the GAAP hierarchy should reside in the accounting literature established by the FASB and is issuing this Statement to achieve that result. SFAS No. 162 is effective sixty days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411. The adoption of this standard is not anticipated to have a material effect on the Company's financial position or results of operations.

In June 2008, the FASB issued an Exposure Draft of a proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies—an amendment of FASB Statements No. 5 and 141(R). The purpose of the proposed statement is intended to improve the quality of financial reporting by expanding disclosures required about certain loss contingencies. Investors and other users of financial information have expressed concerns that current disclosures required in SFAS No. 5, Accounting for Contingencies, do not provide sufficient information in a timely manner to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies. If approved as written, this proposed Statement would expand disclosures about certain loss contingencies in the scope of SFAS No. 5 or SFAS No. 141 (revised 2007), Business Combinations, and would be effective for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

In June 2008, the FASB issued an Exposure Draft of a proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities—an amendment of FASB Statement No. 133. The purpose of the proposed Statement is intended to simplify hedge accounting resulting in increased comparability of financial results for entities that apply hedge accounting. Specifically, the proposed statement would eliminate the multiple methods of hedge accounting currently being used for the same transaction. It also would require an entity to designate all risks as the hedged risk (with certain exceptions) in the hedged item or transaction, thus better reflecting the economics of such items and transactions in the financial statements. Additional objectives of the proposed Statement are to: simplify accounting for hedging activities; improve the financial reporting of hedging activities to make the accounting model and associated disclosures more useful and easier to understand for users of financial statements; resolve major practice issues related to hedge accounting that have arisen under Statement 133, Accounting for Derivative Instruments and Hedging Activities; and address differences resulting from recognition and measurement anomalies between the accounting for derivative instruments and the accounting for hedged items or transactions. If approved as written, the proposed Statement would require application of the amended hedging requirements for financial statements issued for fiscal years beginning after June 15, 2009, and interim periods within those fiscal years.

In October 2008, the FASB issued FASB Staff Position No. 157-3, Determining the Fair Value of an Asset When the Market for That Asset Is Not Active. FSP 157-3 clarifies how SFAS No. 157 Fair Value Measurements should be applied when valuing securities in markets that are not active and illustrates how an entity would determine fair value in this circumstance. The FSP states that an entity should not automatically conclude that a particular transaction price is determinative of fair value. In a dislocated market, judgment is required to evaluate whether individual transactions are forced liquidations or distressed sales. When relevant observable market information is not available, a valuation approach that incorporates management's judgments about the assumptions that market participants would use in pricing the asset in a current sale transaction would be acceptable. The FSP also indicates that quotes from brokers or pricing services may be relevant inputs when

measuring fair value, but are not necessarily determinative in the absence of an active market for the asset. The adoption of FSP 157-3, effective upon issuance, did not impact the Company’s financial position or results of operations.

NOTE 5: DERIVATIVE FINANCIAL INSTRUMENTS

In the normal course of business, the Company uses derivative financial instruments (primarily interest rate swaps) to assist in its interest rate risk management. In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , all derivatives are measured and reported at fair value on the Company's consolidated statement of financial condition as either an asset or a liability. For derivatives that are designated and qualify as a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings during the period of the change in the fair values. For all hedging relationships, derivative gains and losses that are not effective in hedging the changes in fair value of the hedged item are recognized immediately in current earnings during the period of the change. Similarly, the changes in the fair value of derivatives that do not qualify for hedge accounting under SFAS No. 133 are also reported currently in earnings in noninterest income.

The net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. The net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income.

At the inception of the hedge and quarterly thereafter, a formal assessment is performed to determine whether changes in the fair values of the derivatives have been highly effective in offsetting the changes in the fair values of the hedged item and whether they are expected to be highly effective in the future. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking the hedge. This process includes identification of the hedging instrument, hedged item, risk being hedged and the method for assessing effectiveness and measuring ineffectiveness. In addition, on a quarterly basis, the Company assesses whether the derivative used in the hedging transaction is highly effective in offsetting changes in fair value of the hedged item and measures and records any ineffectiveness. The Company discontinues hedge accounting prospectively when it is determined that the derivative is or will no longer be effective in offsetting changes in the fair value of the hedged item, the derivative expires, is sold or terminated or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

The estimates of fair values of the Company's derivatives and related liabilities are calculated by an independent third party using proprietary valuation models. The fair values produced by these valuation models are in part theoretical and reflect assumptions which must be made in using the valuation models. Small changes in assumptions could result in significant changes in valuation. The risks inherent in the determination of the fair value of a derivative may result in income statement volatility.

The Company uses derivatives to modify the repricing characteristics of certain assets and liabilities so that changes in interest rates do not have a significant adverse effect on net interest income and cash flows and to better match the repricing profile of its interest-sensitive assets and

liabilities. As a result of interest rate fluctuations, certain interest-sensitive assets and liabilities will gain or lose market value. In an effective fair value hedging strategy, the effect of this change in value will generally be offset by a corresponding change in value on the derivatives linked to the hedged assets and liabilities.

At September 30, 2008, the Company had six SFAS No. 133 designated swaps with Lehman Brothers Special Financing, Inc. (“Lehman”). On September 15, 2008, Lehman filed for bankruptcy protection and hedge accounting was immediately terminated. The fair market value of the underlying hedged items (certificates of deposit) through September 15, 2008, is being amortized over the remaining life of the hedge period on a straight-line basis. The fair market value of the swaps as of September 15, 2008, included both assets and liabilities totaling a net asset of $235,000. These swaps were valued using the income approach with observable Level 2 market expectations at the measurement date and standard valuation techniques to convert future amounts to a single discounted present amount. The Level 2 inputs are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts on LIBOR for the first two years) and inputs other than quoted prices that are observable for the asset or liability (specifically LIBOR cash and swap rates, volatilities and credit risk at commonly quoted intervals). Mid-market pricing is used as a practical expedient for fair value measurements. The Company has a netting agreement with Lehman and the collectability of the net asset is uncertain at this time. The Company has a valuation allowance of $235,000 on the asset as of September 30, 2008.

At September 30, 2008 and December 31, 2007, the Company's fair value hedges include interest rate swaps to convert the economic interest payments on certain brokered CDs from a fixed rate to a floating rate based on LIBOR. At September 30, 2008, these fair value hedges were considered to be highly effective and any hedge ineffectiveness was deemed not material. The notional amounts of the liabilities being hedged were $37.6 million and $419.2 million at September 30, 2008 and December 31, 2007, respectively. At September 30, 2008, swaps in a net settlement receivable position totaled $37.6 million and swaps in a net settlement payable position totaled $-0-. At December 31, 2007, swaps in a net settlement receivable position totaled $225.7 million and swaps in a net settlement payable position totaled $193.5 million. The net gains recognized in earnings on fair value hedges were $32,000 and $157,000 for the three months ended September 30, 2008 and 2007, respectively. The net gains recognized in earnings on fair value hedges were $5.3 million and $843,000 for the nine months ended September 30, 2008 and 2007, respectively.

NOTE 6: STOCKHOLDERS' EQUITY

Previously, the Company's stockholders approved the Company's reincorporation to the State of Maryland. Under Maryland law, there is no concept of "Treasury Shares." Instead, shares purchased by the Company constitute authorized but unissued shares under Maryland law. Accounting principles generally accepted in the United States of America state that accounting for treasury stock shall conform to state law. The cost of shares purchased by the Company has been allocated to Common Stock and Retained Earnings balances.

NOTE 7: INVESTMENT SECURITIES

	September 30, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value	Tax Equivalent Yield
	(Dollars in thousands)				
AVAILABLE -FOR-SALE SECURITIES:					
U.S. government agencies	$ 34,967	$ ---	$ 1,379	$ 33,588	6.41%
Collateralized mortgage obligations	76,790	23	3,032	73,781	5.46
Mortgage-backed securities	343,169	1,633	1,162	343,640	5.22
Corporate bonds	1,501	---	463	1,038	8.50
States and political subdivisions	55,483	14	3,891	51,606	6.17
Equity securities	3,608	---	1,546	2,062	3.79
Total available-for-sale securities	$ 515,518	$ 1,670	$ 11,473	$ 505,715	5.44%
HELD-TO-MATURITY SECURITIES:					
States and political subdivisions	$ 1,360	$ 83	---	$ 1,443	7.49%
Total held-to-maturity securities	$ 1,360	$ 83	---	$ 1,443	7.49%

During the three months ended September 30, 2008, the Company determined that the impairment of its investment in FNMA/FHLMC perpetual preferred stock with an original cost of $5.8 million had become other than temporary. Consequently, the Company recorded a $5.3 million charge to income.

	December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value	Tax Equivalent Yield
	(Dollars in thousands)				
AVAILABLE -FOR-SALE SECURITIES:					
U.S. government agencies	$ 126,117	$ 53	$ 375	$ 125,795	5.81%
Collateralized mortgage obligations	39,769	214	654	39,329	5.65
Mortgage-backed securities	183,023	1,030	916	183,137	4.92
Corporate bonds	1,501	---	25	1,476	8.50
States and political subdivisions	62,572	533	453	62,652	6.17
Equity securities	12,874	4	239	12,639	7.42
Total available-for-sale securities	$ 425,856	$ 1,834	$ 2,662	$ 425,028	5.52%

HELD-TO-MATURITY SECURITIES:									
States and political subdivisions	$	1,420	$	88	---	$	1,508		7.48%
Total held-to-maturity securities	$	1,420	$	88	---	$	1,508		7.48%

11

NOTE 8: LOANS AND ALLOWANCE FOR LOAN LOSSES

	September 30, 2008	December 31, 2007
	(In Thousands)	
One-to four-family residential mortgage loans	$ 206,101	$ 185,253
Other residential mortgage loans	120,344	87,177
Commercial real estate loans	484,476	471,573
Other commercial loans	141,017	207,059
Industrial revenue bonds	60,905	61,224
Construction loans	683,113	919,059
Installment, education and other loans	177,650	154,015
Prepaid dealer premium	14,027	10,759
Discounts on loans purchased	(5)	(6)
Undisbursed portion of loans in process	(89,318)	(254,562)
Allowance for loan losses	(29,379)	(25,459)
Deferred loan fees and gains, net	(2,348)	(2,698)
	$ 1,766,583	$ 1,813,394
Weighted average interest rate	6.42%	7.58%

NOTE 9: DEPOSITS

	September 30, 2008	December 31, 2007
	(In Thousands)	
Time Deposits:		
0.00% - 1.99%	$ 44,857	$ 598
2.00% - 2.99%	159,879	22,850
3.00% - 3.99%	454,799	93,717
4.00% - 4.99%	558,245	470,718
5.00% - 5.99%	82,740	497,877
6.00% - 6.99%	901	10,394
7.00% and above	185	374
Total time deposits (3.69% - 4.83%)	1,301,606	1,096,528
Non-interest-bearing demand deposits	142,549	166,231
Interest-bearing demand and savings deposits (1.42% - 2.75%)	407,832	491,135
	1,851,987	1,753,894
Interest rate swap fair value adjustment	2,487	9,252
Total Deposits	$ 1,854,474	$ 1,763,146

NOTE 10: FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements, which defines fair value and establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 has been applied prospectively as of the beginning of this

fiscal year. The adoption of SFAS No. 157 did not have an impact on our financial statements except for the expanded disclosures noted below.

The following definitions describe the fair value hierarchy of levels of inputs used in the Fair Value Measurements.

- Quoted prices in active markets for identical assets or liabilities (Level 1): Inputs that are quoted unadjusted prices in active markets for identical assets that the Company has the ability to access at the measurement date. An active market for the asset is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

- Other observable inputs (Level 2): Inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity including quoted prices for similar assets, quoted prices for securities in inactive markets and inputs derived principally from or corroborated by observable market data by correlation or other means.

- Significant unobservable inputs (Level 3): Inputs that reflect assumptions of a source independent of the reporting entity or the reporting entity's own assumptions that are supported by little or no market activity or observable inputs.

Financial instruments are broken down as follows by recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be remeasured at fair value in the financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be remeasured at fair value after initial recognition in the financial statements at some time during the reporting period.

The following is a description of valuation methodologies used for assets recorded at fair value on a recurring basis at September 30, 2008.

Securities Available for Sale. Investment securities available for sale are recorded at fair value on a recurring basis. The fair values used by the Company are obtained from an independent pricing service, which represent either quoted market prices for the identical or fair values determined by pricing models, or other model-based valuation techniques, that consider observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems. Recurring Level 1 securities include exchange traded equity securities. Recurring Level 2 securities include U.S. government agency securities, mortgage-backed securities, collateralized mortgage obligations, state and municipal bonds and U.S. government agency equity securities. Recurring Level 3 securities include one U.S. government agency security and one corporate debt security.

	Fair value September 30, 2008	Fair value measurements at September 30, 2008, using Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(Dollars in thousands)		
Available for sale securities:				
U.S government agencies	$ 33,588	$ ---	$ 23,988	$ 9,600
Collateralized mortgage obligations	73,781	---	73,781	---
Mortgage-backed securities	343,640	---	343,640	---
Corporate bonds	1,038	654	---	384
States and political subdivisions	51,606	---	51,606	---
Equity securities	2,062	864	1,198	---
Total available-for-sale securities	$ 505,715	$ 1,518	$ 494,213	$ 9,984

The following is a reconciliation of activity for available-for-sale securities measured at fair value based on significant unobservable (Level 3) information. $9.6 million of U.S. government agency securities were reclassified from Level 2 to Level 3 due to a valuation provided by a bond trading desk, which was heavily influenced by unobservable market inputs during the quarter ended September 30, 2008.

	Investment Securities (In thousands)
Balance, July 1, 2008	$ 445
Unrealized loss included in comprehensive income	(461)
Transfer from Level 2 to Level 3	10,000
Balance, September 30, 2008	$ 9,984

	Investment Securities (In thousands)
Balance, January 1, 2008	$ 10,450
Unrealized loss included in comprehensive income	(466)
Balance, September 30, 2008	$ 9,984

Interest Rate Swap Agreements. The fair value is estimated by a third party using inputs that are observable or that can be corroborated by observable market data and, therefore, are classified within Level 2 of the valuation hierarchy. These fair value estimations include primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. Fair value estimates related to the Company's hedged deposits are derived in the same manner. As of September 30, 2008, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its interest rate swap positions, and determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. The fair value of interest rate swaps at September 30, 2008, was a liability of $0.4 million.

The following is a description of valuation methodologies used for assets recorded at fair value on a nonrecurring basis at September 30, 2008.

Loans Held for Sale. Mortgage loans held for sale are recorded at the lower of carrying value or fair value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as Nonrecurring Level 2. Write-downs to fair value typically do not occur as the Company generally enters into commitments to sell individual mortgage loans at the time the loan is originated to reduce market risk. The Company typically does not have commercial loans held for sale.

Impaired Loans. A loan is considered to be impaired when it is probable that all of the principal and interest due may not be collected according to its contractual terms. Generally, when a loan is considered impaired, the amount of reserve required under SFAS No. 114 is measured based on the fair value of the underlying collateral. The Company makes such measurements on all material loans deemed impaired using the fair value of the collateral for collateral dependent loans. The fair value of collateral used by the Company is determined by obtaining an observable market price or by obtaining an appraised value from an independent, licensed or certified appraiser, using observable market data. This data includes information such as selling price of similar properties and capitalization rates of similar properties sold within the market, expected future cash flows or earnings of the subject property based on current market expectations, and other relevant factors. In addition, management may apply selling and other discounts to the underlying collateral value to determine the fair value. If an appraised value is not available, the fair value of the impaired loan is determined by an adjusted appraised value including unobservable cash flows.

The Company records impaired loans as Nonrecurring Level 3. If a loan’s fair value as estimated by the Company is less than its carrying value, the Company either records a charge-off of the portion of the loan that exceeds the fair value or establishes a specific reserve as part of the allowance for loan losses. In accordance with the provisions of SFAS No. 114, impaired loans with a carrying value of $47.9 million, with an associated valuation reserve of $4.9 million, were recorded at their fair value of $43.0 million at September 30, 2008. Losses of $3.3 million and $47.2 million related to impaired loans were recognized in earnings through the provision for loan losses during the three and nine months ended September 30, 2008, respectively.

NOTE 11: EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

In response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (“EESA”) was signed into law. Pursuant to EESA, the U.S. Treasury will have the authority to, among other things, purchase up to $700 billion of mortgages, mortgaged-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. On October 14, 2008, the Department of the Treasury announced that it would purchase equity stakes in a wide variety of banks and thrifts using $250 billion of capital from the EESA funds under a program known as the Troubled Asset Relief Program Capital Purchase Program (the “TARP Capital Purchase Program”). The TARP Capital Purchase Program involves the purchase by the Treasury of preferred stock in financial institutions with warrants to purchase common stock. Also on October 14, 2008, the FDIC announced the Temporary Liquidity Guarantee Program, which provides for the guarantee of newly-issued senior unsecured debt of banks, thrifts and certain holding companies as well as full deposit insurance coverage for non-interest bearing deposit transaction accounts, regardless of dollar amount. Unlimited coverage for non-interest bearing transaction accounts under the Temporary Liquidity Guarantee Program is available for 30 days without charge and thereafter at a cost of 10 basis points per annum. The Company is currently assessing its participation in the TARP Capital Purchase Program and the Temporary Liquidity Guarantee Program.

15

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

When used in this Quarterly Report on Form 10-Q and in future filings by the Company with the Securities and Exchange Commission (the "SEC"), in the Company's press releases or other public or shareholder communications, and in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "intends" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses, the Company's ability to access cost-effective funding, fluctuations in real estate values and both residential and commercial real estate market conditions, demand for loans and deposits in the Company's market area and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake-and specifically declines any obligation-to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States and general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company believes that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining an allowance level believed by management to be sufficient to absorb estimated loan losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates of, including, among others, expected default probabilities, loss once loans default, expected commitment usage, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses, and general amounts for historical loss experience.

The process also considers economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods. In addition, the Bank's regulators could require additional provisions for loan losses as part of their examination process. The Bank's annual regulatory examination was held in October 2008. The examination field work is complete and the Bank is awaiting the formal written report.

Additional discussion of the allowance for loan losses is included in the Company's 2007 Annual Report on Form 10-K under the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Allowances for Losses on Loans and Foreclosed Assets." Judgments and assumptions used by management in the past have resulted in an overall allowance for loan losses that has been sufficient to absorb estimated loan losses. Inherent in this process is the evaluation of individual significant credit relationships. From time to time certain credit relationships may deteriorate due to payment performance, cash flow of the borrower, value of collateral, or other factors. In these instances, management may have to revise its loss estimates and assumptions for these specific credits due to changing circumstances. In some cases, additional losses may be realized; in other instances, the factors that led to the deterioration may improve or the credit may be refinanced elsewhere and allocated allowances may be released from the particular credit. For the periods included in these financial statements, management's overall methodology for evaluating the allowance for loan losses has not changed significantly.

In addition, the Company considers that the determination of the valuations of foreclosed assets held for sale involves a high degree of judgment and complexity. The carrying value of foreclosed assets reflects management's best estimate of the amount to be realized from the sales of the assets. While the estimate is generally based on a valuation by an independent appraiser or recent sales of similar properties, the amount that the Company realizes from the sales of the assets could differ materially from the carrying value reflected in these financial statements, resulting in losses that could adversely impact earnings in future periods.

General

The profitability of the Company and, more specifically, the profitability of its primary subsidiary, Great Southern Bank (the "Bank"), depends primarily on its net interest income. Net interest income is the difference between the interest income the Bank earns on its loans and investment portfolio, and the interest it pays on interest-bearing liabilities, which consists mainly of interest paid on deposits and borrowings. Net interest income is affected by the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid on these balances. When interest-earning assets approximate or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income.

In the nine months ended September 30, 2008, Great Southern's net loans decreased $46.8 million, or 2.6%, from $1.81 billion at December 31, 2007, to $1.77 billion at September 30, 2008. As loan demand is affected by a variety of factors, including general economic conditions, and because of the competition we face, we cannot be assured that our loan growth will match or exceed the level of increases achieved in prior years. Based upon the current lending environment and economic conditions, the Company does not expect to grow the overall loan portfolio significantly, if at all, at this time. However, some loan categories have experienced

increases. The main loan areas experiencing increases in the first nine months of 2008 were commercial real estate loans, one- to four-family and multifamily real estate loans and consumer loans, partially offset by lower balances in construction loans and commercial business loans. In the nine months ended September 30, 2008, outstanding residential and commercial construction loan balances decreased $84.4 million, to $601.6 million at September 30, 2008. In addition, the undisbursed portion of construction and land development loans decreased $165.3 million from $254.6 million at December 31, 2007, to $89.3 million at September 30, 2008. The Company's strategy continues to be focused on maintaining credit risk and interest rate risk at appropriate levels given the current credit and economic environments.

In addition, the level of non-performing loans and foreclosed assets may affect our net interest income and net income. While we have not historically had an overall high level of charge-offs on our non-performing loans prior to 2008, we do not accrue interest income on these loans and do not recognize interest income until the loan is repaid or interest payments have been made for a period of time sufficient to provide evidence of performance on the loans. Generally, the higher the level of non-performing assets, the greater the negative impact on interest income and net income. We expect loan loss provision, non-performing assets and foreclosed assets to remain elevated. In addition, expenses related to the credit resolution process should also remain elevated.

In the nine months ended September 30, 2008, Great Southern's available-for-sale securities increased $80.7 million, or 19.0%, from $425 million at December 31, 2007, to $506 million at September 30, 2008. The Company’s mix of securities changed in the nine month period primarily in two categories. U.S. Government agency debt securities decreased $92.2 million primarily due to maturing short-term securities and longer term securities that were called at par by the issuing agency. The Company elected to replace these securities with U.S. Government agency mortgage-backed securities, which increased $160.5 million, to cover pledging requirements for public funds and customer repurchase agreements. Most of these agency mortgage-backed securities have interest rates that are fixed for a period of five to ten years and then adjust annually.

The Company attracts deposit accounts through our retail branch network, correspondent banking and corporate services areas, and brokered deposits. The Company then utilizes these deposit funds, along with Federal Home Loan Bank (FHLBank) advances and other borrowings, to meet loan demand. In the nine months ended September 30, 2008, total deposit balances increased $91.3 million, or 5.2%. However, the mix of deposits continued to shift from checking deposits to certificates of deposit, primarily brokered CDs. Interest-bearing transaction accounts decreased $83.3 million while non-interest-bearing checking accounts decreased $23.7 million. Retail certificates of deposit decreased $20.1 million. There is a high level of competition for deposits in our markets. While it is our goal to gain checking account and certificate of deposit market share in our branch footprint, we cannot be assured of this in future periods. In 2007 and so far in 2008, our non-interest-bearing checking account balances have decreased, primarily as a result of lower balances being kept in correspondent bank customers' accounts. These lower balances are due to the effects of the correspondent customers clearing checks through other avenues using electronic presentment, thus requiring lower compensating balances. If this decrease in non-interest-bearing checking account balances relative to the balances in other deposit categories continues, it could negatively impact our net interest income. A significant amount of the reduction in interest-bearing checking balances was the result of customers moving funds into customer reverse repurchase agreements.

Total brokered deposits were $898.2 million at September 30, 2008, up from $674.6 million at December 31, 2007. Included in these totals at September 30, 2008 and December 31, 2007, were Great Southern Bank customer deposits totaling $101.8 million and $88.8 million, respectively, that are part of the CDARS program which allows bank customers to maintain balances in an insured manner that would otherwise exceed the FDIC deposit insurance limit. The Company decided to increase the amount of longer-term brokered certificates of deposit in the first nine months of 2008 to provide liquidity for operations and to maintain in reserve its available secured funding lines with the Federal Home Loan Bank (FHLBank) and the Federal Reserve Bank. In the first nine months of 2008, the Company issued approximately $292 million of new brokered certificates which are fixed rate certificates with maturity terms of generally two to four years, which the Company (at its discretion) may redeem at par generally after six months. In addition in the same period, the Company issued approximately $87 million of new brokered certificates, which are fixed rate certificates with maturity terms of generally two to four years, which the Company may not redeem prior to maturity. There are no interest rate swaps associated with these brokered certificates.

These funding changes contributed to decreases in our net interest income and net interest margin. These longer-term certificates carry an interest rate that is approximately 150 basis points higher than the interest rate that the Company would have paid if it instead utilized short-term advances from the FHLBank. The Company decided the higher rate was justified by the longer term and the ability to keep committed funding lines available. The net interest margin was also negatively impacted as the Company originated some of the new certificates in advance of the anticipated terminations of the existing certificates, thereby causing the Company to have excess funds for a period of time. These excess funds were invested in short-term cash equivalents at rates that at times caused the Company to earn a negative spread. Partially offsetting the increase in brokered CDs, several existing brokered certificates were redeemed by the Company in the first half of 2008 as the related interest rate swaps were terminated by the swap counterparties. These redeemed certificates had effective interest rates through the interest rate swaps of approximately 90-day LIBOR. Interest rate swap notional amounts have decreased from $419 million at December 31, 2007, to $38 million at September 30, 2008.

Our ability to fund growth in future periods may also be dependent on our ability to continue to access brokered deposits and FHLBank advances. In times when our loan demand has outpaced our generation of new deposits, we have utilized brokered deposits and FHLBank advances to fund these loans. These funding sources have been attractive to us because we can create variable rate funding, if desired, which more closely matches the variable rate nature of much of our loan portfolio. While we do not currently anticipate that our ability to access these sources will be reduced or eliminated in future periods, if this should happen, the limitation on our ability to fund additional loans would adversely affect our business, financial condition and results of operations.

Our net interest income may be affected positively or negatively by market interest rate changes. A large portion of our loan portfolio is tied to the "prime" rate and adjusts immediately when this rate adjusts. We also have a portion of our liabilities that will reprice with changes to the federal funds rate or the three-month LIBOR rate. We monitor our sensitivity to interest rate changes on an ongoing basis (see "Quantitative and Qualitative Disclosures About Market Risk").

Ongoing changes in the level and shape of the interest rate yield curve pose challenges for interest rate risk management. Beginning in the second half of 2004 and through September 30, 2006, the Board of Governors of the Federal Reserve System (the "FRB") increased short-term interest rates through steady increases to the Federal Funds rate. Other short-term rates, such as LIBOR and short-term U.S. Treasury rates, increased in conjunction with these increases by the FRB. By September 30, 2006, the FRB had raised the Federal Funds rates by 4.25% (from 1.00% in June 2004) and other short-term rates rose by corresponding amounts. However, there was not a parallel shift in the yield curve; intermediate and long-term interest rates did not increase at a corresponding pace. This caused the shape of the interest rate yield curve to become much flatter, which creates different issues for interest rate risk management. On September 18, 2007, the FRB decreased the Federal Funds rate by 50 basis points and many market interest rates began to fall in the following weeks. In the months following September 2007, the FRB has reduced the Federal Funds rate by an additional 375 basis points. The Federal Funds rate now stands at 1.00%. However, funding costs for most financial services companies have not declined in tandem with these reductions in the Federal Funds rate. Competition for deposits, the desire for longer term funding, elevated LIBOR interest rates and wide credit spreads have kept borrowing costs relatively high in the current environment.

Another factor that continues to negatively impact net interest income is the elevated level of LIBOR interest rates compared to Federal Funds rates as a result of credit and liquidity concerns in financial markets. These LIBOR interest rates were elevated approximately 50-60 basis points compared to historical averages versus the stated Federal Funds rate for most of the three months ended September 30, 2008. In the latter portion of September 2008 and into October 2008, LIBOR rates spiked even higher in comparison to the stated Federal Funds rate. At times, these LIBOR interest rates have been elevated over 200 basis points compared to historical averages. The Company has interest rate swaps and other borrowings that are indexed to LIBOR, thereby causing increased funding costs. Funding costs related to brokered certificates of deposit have also been elevated due to competition by issuers seeking to generate significant funding.

The Federal Reserve most recently cut interest rates on October 29, 2008. Great Southern has a significant portfolio of loans which are tied to a “prime rate” of interest. Some of these loans are tied to a national index of “prime,” while most are indexed to “Great Southern prime.” The Company has elected to leave its “Great Southern prime rate” of interest at 5.00% in light of the current highly competitive funding environment for deposits, including LIBOR rates that have been over 4.00%. This does not affect a large number of customers as a majority of the loans indexed to “Great Southern prime” are already at interest rate floors which are provided for in individual loan documents. But for the interest rate floors, a rate cut by the Federal Reserve generally would have an anticipated immediate negative impact on the Company’s net interest income due to the large total balance of loans which generally adjust immediately as the Federal Funds rate adjusts. Because the Federal Funds rate is already very low, there may also be a negative impact on the Company’s net interest income due to the Company’s inability to lower its funding costs in the current environment. Usually any negative impact is expected to be offset over the following 60- to 120-day period, and subsequently is expected to have a positive impact, as the Company’s interest rates on deposits, borrowings and interest rate swaps would normally also go down as a result of a reduction in interest rates by the Federal Reserve, assuming normal credit, liquidity and competitive loan and deposit pricing pressures. However, the operating environment has not been normal and interest costs for deposits and borrowings have been and continue

to be elevated because of abnormal credit, liquidity and competitive pricing pressures; therefore we expect our net interest margin will continue to be compressed. Any anticipated positive impact will likely be reduced by the change in the funding mix noted above, as well as retail deposit competition in the Company’s market areas.

In addition, Great Southern's net interest margin has been negatively affected by certain characteristics of some of its loans, deposit mix, loan and deposit pricing by competitors, and timing of interest rate changes by the FRB as compared to interest rate changes in the financial markets. For the nine months ended September 30, 2008 and 2007, interest income was reduced $1.0 million and $1.2 million, respectively, due to the reversal of accrued interest on loans which were added to non-performing status during those periods. This reduced net interest income and net interest margin. In addition, net interest income and net interest margin were negatively impacted by the effects of the accounting entries recorded for certain interest rate swaps (amortization of deposit broker origination fees). This amortization expense reduced net interest income by $2.5 million and $649,000 in the nine months ended September 30, 2008 and 2007, respectively.

The negative impact of declining loan interest rates has been partially mitigated by the positive effects of the Company’s loans which have interest rate floors. At September 30, 2008, the Company had a portfolio of prime-based loans totaling approximately $1.03 billion with rates that change immediately with changes to the prime rate of interest. Of this total, $744 million represented loans which had interest rate floors. These floors were at varying rates, with $203 million of these loans having floor rates of 7.0% or greater and another $495 million of these loans having floor rates between 5.0% and 7.0%. At September 30, 2008, $668 million of these loans were at their floor rates. During 2003 and 2004, the Company's loan portfolio had loans with rate floors that were much lower. However, since market interest rates were also much lower at that time, these loan rate floors went into effect and established a loan rate which was higher than the contractual rate would have otherwise been. This contributed to a loan yield for the entire portfolio which was approximately 139 and 55 basis points higher than the "prime rate of interest" at December 31, 2003 and 2004, respectively. As interest rates rose in the second half of 2004 and throughout 2005 and 2006, these interest rate floors were exceeded and the loans reverted back to their normal contractual interest rate terms. At December 31, 2005, the loan yield for the portfolio was approximately 8 basis points higher than the "prime rate of interest," resulting in lower interest rate margins. At December 31, 2006, the loan portfolio yield was approximately 5 basis points lower than the "prime rate of interest." During the latter portion of 2007 and into 2008, as the "prime rate of interest" has gone down, the Company's loan portfolio again has had loans with rate floors that went into effect and established a loan rate which was higher than the contractual rate would have otherwise been. This contributed to a loan yield for the entire portfolio which was approximately 33 basis points higher than the "prime rate of interest" at December 31, 2007. At September 30, 2008, the loan yield for the portfolio had increased to a level that was approximately 142 basis points higher than the national "prime rate of interest." In October 2008, the national “prime rate of interest” decreased an additional 100 basis points. While interest rate floors have had an overall positive effect on the Company’s results, they do subject the Company to the risk that borrowers will elect to refinance their loans with other lenders.

The Company's profitability is also affected by the level of its non-interest income and operating expenses. Non-interest income consists primarily of service charges and ATM fees, commissions earned by our travel, insurance and investment divisions, late charges and prepayment fees on loans, gains on sales of loans and available-for-sale investments and other general operating income. Non-interest income is also affected by the Company's interest rate hedging activities. Operating expenses consist primarily of salaries and employee benefits, occupancy-related expenses, expenses related to foreclosed assets, postage, insurance, advertising and public relations, telephone, professional fees, office expenses and other general operating expenses.

Non-interest income for the third quarter of 2008 decreased primarily as a result of the impairment write-down in value of the Company’s investments in available-for-sale Fannie Mae and Freddie Mac perpetual preferred stock. This write-down totaled $5.3 million on a pre-tax basis. As previously reported in the Company’s Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2008, the Company’s investments in Fannie Mae and Freddie Mac securities were included in securities available for sale at a cost of $4.0 million and $1.8 million, respectively. These securities have recently traded at 5 to 10 percent of par value and are currently not expected to pay dividends. It is unclear if or when the values of such investment securities will improve, or whether such values will deteriorate further. Based on these developments, the Company recorded an other-than-temporary impairment. The Company does not own any other equity securities issued by Fannie Mae or Freddie Mac. Third quarter 2008 commission income from the Company’s travel, insurance and investment divisions decreased $471,000, or 19.3%, compared to the same period in 2007. Part of this decrease was in the investment division as a result of the alliance formed with Ameriprise Financial Services through Penney, Murray and Associates. As a result of this change, Great Southern now records most of its investment services activity on a net basis in non-interest income. Thus, non-interest expense related to the investment services division is also reduced. The Company’s travel division also experienced a decrease in commission income.

The change in the fair value of certain interest rate swaps and the related change in fair value of hedged deposits resulted in an increase in non-interest income of $5.3 million in the nine months ended September 30, 2008, and an increase of $843,000 in the nine months ended September 30, 2007. Income of this magnitude related to the change in the fair value of certain interest rate swaps and the related change in the fair value of hedged deposits should not be expected in future quarters. This income is part of a 2005 accounting restatement in which approximately $3.4 million (net of taxes) was charged against retained earnings in 2005. This charge has been (and continues to be) recovered in subsequent periods as interest rate swaps matured or were terminated by the swap counterparty.

Total non-interest expense increased 10.0% in the three months ended September 30, 2008 compared to the same period in 2007. Total non-interest expense increased 11.4% in the nine months ended September 30, 2008 compared to the same period in 2007. These increases were due to expenses related to problem loans and foreclosed assets, expenses related to FDIC insurance premiums and the continued growth of the Company. Excluding the increase in expenses on foreclosed assets, non-interest expenses decreased $413,000, or 3.1%, in the three months ended September 30, 2008 compared to the same period in 2007. Excluding the increase in expenses on foreclosed assets, non-interest expenses increased $2.1 million, or 5.7%, in the nine months ended September 30, 2008 compared to the same period in 2007. Due to the increase in the level of foreclosed assets, foreclosure-related expenses in the third quarter of 2008 were higher than the comparable 2007 period by approximately $1.7 million. For the same reason, foreclosure-related expenses increased $2.2 million in the nine months ended September

30, 2008, compared to the same period in 2007. In 2007, the Federal Deposit Insurance Corporation (FDIC) began to once again assess insurance premiums on insured institutions. Under the new pricing system, institutions in all risk categories, even the best rated, are charged an FDIC premium. Great Southern received a deposit insurance credit as a result of premiums previously paid. The Company's credit offset assessed premiums for the first half of 2007, but premiums were owed by the Company in the latter half of 2007 and into 2008. The Company incurred additional deposit insurance expense of $39,000 in the third quarter of 2008 compared to the same period in 2007, and the Company expects a similar expense in subsequent quarters. For the nine months ended September 30, 2008, compared to the same period in 2007, the Company incurred additional insurance expense of $753,000.

In addition to the expense increases noted above, the Company's increase in non-interest expense in the first nine months of 2008 compared to the same period in 2007 related to the continued growth of the Company. Late in the first quarter of 2007, Great Southern completed its acquisition of a travel agency in St. Louis. In addition since June 2007, the Company opened banking centers in Springfield, Mo. and Branson, Mo. In the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007, non-interest expenses increased $600,000 related to the ongoing operations of these entities.

The operations of the Bank, and banking institutions in general, are significantly influenced by general economic conditions and related monetary and fiscal policies of regulatory agencies. Deposit flows and the cost of deposits and borrowings are influenced by interest rates on competing investments and general market rates of interest. Lending activities are affected by the demand for financing real estate and other types of loans, which in turn are affected by the interest rates at which such financing may be offered and other factors affecting loan demand and the availability of funds.

Business Initiatives

The Company is expanding its retail banking center network in the St. Louis and Kansas City metropolitan regions. This is part of the Company's overall long-term plan to open two to three banking centers per year as market conditions warrant. The Company's first retail banking center in the St. Louis market is expected to open in 2009. Located in Creve Coeur, Mo., the full-service banking center will complement a loan production office and a Great Southern Travel office already in operation in this market. Construction will be underway soon on a second banking center in the Lee's Summit, Mo., market, a suburb of Kansas City. The banking center should be completed in 2009 and will enhance access and service to Lee's Summit-area customers. Great Southern opened its first Lee's Summit retail location in 2006. Currently, the Company has not slated any new banking center openings beyond 2009.

Effect of Federal Laws and Regulations

Federal legislation and regulation significantly affect the banking operations of the Company and the Bank, and have increased competition among commercial banks, savings institutions, mortgage banking enterprises and other financial institutions. In particular, the capital requirements and operations of regulated depository institutions such as the Company and the Bank have been and will be subject to changes in applicable statutes and regulations from time to

time, which changes could, under certain circumstances, adversely affect the Company or the Bank.

Comparison of Financial Condition at September 30, 2008 and December 31, 2007

During the nine months ended September 30, 2008, the Company increased total assets by $96.2 million to $2.53 billion. Net loans decreased by $46.8 million. In the nine months ended September 30, 2008, gross residential and commercial construction loan balances decreased $235.9 million. The main loan areas experiencing increases in the first nine months of 2008 were commercial real estate loans, one- to four-family and multifamily real estate loans and consumer loans, partially offset by lower average balances in construction loans and commercial business loans. The Company's strategy continues to be focused on maintaining credit risk and interest rate risk at appropriate levels given the current credit and economic environments. The Company does not expect to grow the loan portfolio significantly at this time. Available-for-sale investment securities increased by $80.7 million and cash and cash equivalents increased $42.5 million. For the nine months ended September 30, 2008, the average balance of investment securities and other interest-earning assets increased by $61.0 million compared to the same period in 2007 due to the purchase of securities and interest-bearing deposits to provide liquidity and to be pledged against customer reverse repurchase agreements, public funds deposits and structured repo borrowings. In some instances, the Company invested excess funds in short-term cash equivalents at rates that at times caused the Company to earn a negative spread. While the Company generally earned a positive spread on securities purchased, it was much smaller than the Company's overall net interest spread, having the effect of increasing net interest income but decreasing net interest margin. While there is no specifically stated goal, the available-for-sale securities portfolio has recently been approximately 15% to 20% of total assets. The available-for-sale securities portfolio was 20.0% and 17.5% of total assets at September 30, 2008 and December 31, 2007, respectively. Foreclosed assets increased $12.4 million during the nine months ended September 30, 2008. See “Non-performing assets – foreclosed assets” for additional information on the Company’s foreclosed assets.

Total liabilities increased $117.3 million from December 31, 2007 to $2.36 billion at September 30, 2008. Deposits increased $91.3 million and securities sold under reverse repurchase agreements with customers increased $85.6 million. Partially offsetting these increases, short-term borrowings decreased $20.5 million and FHLBank advances decreased $91.1 million, from $213.9 million at December 31, 2007, to $122.8 million at September 30, 2008. The level of FHLBank advances and short-term borrowings will fluctuate depending on growth in the Company's loan portfolio and other funding needs and sources of the Company. These decreases during the nine months ended September 30, 2008, primarily related to the maturity of very short-term FHLBank advances and Federal Reserve Term Auction Facility funds which had been obtained near the end of 2007 to meet funding needs at year-end. In September 2008, the Company entered into a structured repo borrowing transaction for $50 million. This borrowing bears interest at a fixed rate of 4.34% if three-month LIBOR remains at 2.81% or less on quarterly interest reset dates; if LIBOR is above the 2.81% rate on quarterly interest reset dates, then the Company’s borrowing rate decreases by 2.5 times the difference in LIBOR (up to 250 basis points). Deposits (excluding brokered and national certificates of deposit) decreased $114.1 million from December 31, 2007. Retail CDs and non-interest-bearing transaction accounts decreased $20.1 million and $23.7 million, respectively. Interest-bearing checking accounts

(mainly money market accounts) decreased $83.3 million. Checking account balances totaled $550.4 million at September 30, 2008, down from $657.4 million at December 31, 2007. A significant amount of this reduction in checking balances was moved into customer reverse repurchase agreements as noted above. Total brokered deposits were $898.2 million at September 30, 2008, up from $674.6 million at December 31, 2007. Included in these totals at September 30, 2008 and December 31, 2007, were Great Southern Bank customer deposits totaling $101.8 million and $88.8 million, respectively, that are part of the CDARS program which allows bank customers to maintain balances in an insured manner that would otherwise exceed the FDIC deposit insurance limit. The Company decided to increase the amount of longer-term brokered certificates of deposit in the first nine months of 2008 to provide liquidity for operations and to maintain in reserve its available secured funding lines with the Federal Home Loan Bank and the Federal Reserve Bank. In the first nine months of 2008, the Company issued approximately $292 million of new brokered certificates which are fixed rate certificates with maturity terms of generally two to four years, which the Company (at its discretion) may redeem at par generally after six months. In addition in the same period, the Company issued approximately $87 million of new brokered certificates, which are fixed rate certificates with maturity terms of generally two to four years, which the Company may not redeem prior to maturity. There are no interest rate swaps associated with these brokered certificates.

Stockholders' equity decreased $21.1 million from $189.9 million at December 31, 2007 to $168.8 million at September 30, 2008. The Company recorded a net loss of $8.0 million for the nine months ended September 30, 2008, dividends declared were $7.2 million, net repurchases of the Company's common stock were $149,000 and accumulated other comprehensive loss increased $5.8 million. The increase in accumulated other comprehensive loss resulted from decreases in the fair value of the Company's available-for-sale investment securities. During the nine months ended September 30, 2008, the Company repurchased 21,200 shares of its common stock at an average price of $19.19 per share and issued 1,972 shares at an average price of $13.23 per share to cover stock option exercises.

In the three and nine months ended September 30, 2008, the Company was not aggressively buying back shares of its stock in an effort to conserve its capital. Management may purchase the Company’s common stock from time to time as long as it believes that repurchasing the stock contributes to the overall growth of shareholder value and the maintenance of appropriate capital levels. The number of shares of stock that will be repurchased and the price that will be paid is the result of many factors, several of which are outside the control of the Company. The primary factors, however, are the number of shares available in the market from sellers at any given time, the price of the stock within the market as determined by the market, and the projected impact on the Company's capital and earnings per share.

Results of Operations and Comparison for the Three and Nine Months Ended September 30, 2008 and 2007

General

Including the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, net income decreased $6.5 million, or 88.7%, during the three months ended September 30, 2008, compared to the three months ended September 30, 2007. This decrease

was primarily due to an increase in provision for loan losses of $3.2 million, or 233.3%, an increase in non-interest expense of $1.3 million, or 10.0%, and a decrease in non-interest income of $5.8 million, or 76.5%, partially offset by an increase in net interest income of $435,000, or 2.4%, and a decrease in provision for income taxes of $3.4 million, or 94.9%.

Excluding the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, economically, net income decreased $6.5 million, or 87.8%, during the three months ended September 30, 2008, compared to the three months ended September 30, 2007. This decrease was primarily due to an increase in provision for loan losses of $3.2 million, or 233.3%, an increase in non-interest expense of $1.3 million, or 10.0%, and a decrease in non-interest income of $5.7 million, or 76.3%, partially offset by an increase in net interest income of $368,000, or 2.0%, and a decrease in provision for income taxes of $3.4 million, or 93.8%.

Including the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, net income decreased $30.9 million, or 135.0%, during the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007. This decrease was primarily due to an increase in provision for loan losses of $43.1 million, or 1,044.2%, an increase in non-interest expense of $4.3 million, or 11.4%, and a decrease in non-interest income of $667,000, or 3.0%, partially offset by an increase in net interest income of $735,000, or 1.4%, and a decrease in provision for income taxes of $16.5 million, or 148.0%.

Excluding the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, economically, net income decreased $32.5 million, or 143.4%, during the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007. This decrease was primarily due to an increase in provision for loan losses of $43.1 million, or 1,044.2%, an increase in non-interest expense of $4.3 million, or 11.4%, and a decrease in non-interest income of $5.0 million, or 23.0%, partially offset by an increase in net interest income of $2.5 million, or 4.7%, and a decrease in provision for income taxes of $17.4 million, or 157.5%.

The information presented in the table below and elsewhere in this report excluding hedge accounting entries recorded (for the 2008 and 2007 periods) is not prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The tables below and elsewhere in this report excluding hedge accounting entries recorded (for the 2008 and 2007 periods) contain reconciliations of this information to the reported information prepared in accordance with GAAP. The Company believes that this non-GAAP financial information is useful in its internal management financial analyses and may also be useful to investors because the Company believes that the exclusion of these items from the specified components of net income better reflect the Company's underlying operating results during the periods indicated for the reasons described above. The amortization of deposit broker fees and the net change in fair value of interest rate swaps and related deposits may be volatile. For example, if market interest rates decrease significantly, the interest rate swap counterparties may wish to terminate the swaps prior to their stated maturities. If a swap is terminated, it is likely that the Company would redeem the related deposit account at face value. If the deposit account is redeemed, any unamortized broker fee associated with the deposit account must be written off to interest expense. In addition, if the interest rate swap is terminated, there may be an income or expense impact related to the fair values of the swap and related deposit which were previously recorded

in the Company's financial statements. The effect on net income, net interest income, net interest margin and non-interest income could be significant in any given reporting period.

Selected Financial Data and Non-GAAP Reconciliation
(Dollars in thousands)

	Three Months Ended September 30,			
	2008		2007	
	Dollars	Earnings Per Diluted Share	Dollars	Earnings Per Diluted Share
Reported Earnings	$ 824	$ .06	$ 7,317	$ .54
Amortization of deposit broker origination fees (net of taxes)	90	.01	134	.01
Net change in fair value of interest rate swaps and related deposits (net of taxes)	(14)	--	(90)	(.01)
Earnings excluding impact of hedge accounting entries	$ 900	$ .07	$ 7,361	$ .54

	Nine Months Ended September 30,			
	2008		2007	
	Dollars	Earnings (Loss) Per Diluted Share	Dollars	Earnings (Loss) Per Diluted Share
Reported Earnings	$ (7,997)	$ (.60)	$ 22,860	$ 1.67
Amortization of deposit broker origination fees (net of taxes)	1,607	.12	422	.03
Net change in fair value of interest rate swaps and related deposits (net of taxes)	(3,435)	(.25)	(655)	(.05)
Earnings excluding impact of hedge accounting entries	$ (9,825)	$ (.73)	$ 22,627	$ 1.65

Total Interest Income

Total interest income decreased $7.0 million, or 16.6%, during the three months ended September 30, 2008 compared to the three months ended September 30, 2007. The decrease was due to a $7.6 million, or 20.9%, decrease in interest

income on loans, partially offset by a $692,000, or 13.0%, increase in interest income on investments and other interest-earning assets. Interest income for investment securities and other interest-earning assets increased due to higher average balances, partially offset by lower average rates of interest. Interest income for loans decreased due to significantly lower average rates of interest, partially offset by higher average

balances. The lower average rates were a result of the significant decreases to the prime rate of interest since the third quarter of 2007.

Total interest income decreased $14.1 million, or 11.5%, during the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The decrease was due to a $16.1 million, or 15.0%, decrease in interest income on loans, partially offset by a $2.0 million, or 12.6%, increase in interest income on investments and other interest-earning assets. Interest income for investment securities and other interest-earning assets increased due to higher average balances, partially offset by slightly lower average rates of interest. Interest income for loans decreased due to significantly lower average rates of interest, partially offset by higher average balances. The lower average rates were a result of the significant decreases to the prime rate of interest since the third quarter of 2007.

For the three months ended September 30, 2008, and 2007, interest income was reduced $352,000 and $659,000, respectively, due to the reversal of accrued interest on loans which were added to non-performing status during the quarters. For the nine months ended September 30, 2008, and 2007, interest income was reduced $1.0 million and $1.2 million, respectively, due to the reversal of accrued interest on loans which were added to non-performing status during the periods. Partially offsetting this, the Company collected interest which was previously charged off in the amount of $0 and $76,000 in the three months ended September 30, 2008 and 2007, respectively, and $78,000 and $183,000 in the nine months ended September 30, 2008 and 2007, respectively. The net effect of these reversals and collections reduced net interest income and net interest margin. For the three and nine months ended September 30, 2008, compared to the same periods in 2007, the average balance of investment securities and other interest-earning assets increased by approximately $50-80 million due to excess funds for liquidity and the purchase of very short-term discount notes and other securities to pledge against public funds deposits, customer repurchase agreements and structured repo borrowings. While the Company earned a positive spread on these securities (leading to higher net interest income), it was much smaller than the Company's overall net interest spread, having the effect of decreasing net interest margin. See "Net Interest Income" for additional information on the impact of this interest activity.

Interest Income - Loans

During the three months ended September 30, 2008 compared to the three months ended September 30, 2007, interest income on loans decreased due to lower average interest rates, partially offset by higher average balances. Interest income decreased $8.4 million as the result of lower average interest rates on loans. The average yield on loans decreased from 8.08% during the three months ended September 30, 2007, to 6.28% during the three months ended September 30, 2008. Generally, a rate cut by the FRB would have an anticipated immediate negative impact on interest income and net interest income due to the large total balance of loans which generally adjust immediately as Fed Funds adjust. A large portion of the Bank's loan portfolio is prime-based with interest rate floors and, therefore, adjusts with changes to the "prime rate" of interest. Prior to 2006, when market interest rates were lower, many of these loan rate floors were in effect and established a loan rate which was higher than the contractual rate would have otherwise been. During 2006 and 2007, as market interest rates rose, many of these interest rate floors were exceeded and the loans reverted back to their normal contractual interest

28

rate terms. In the fourth quarter of 2007 and the first nine months of 2008, the FRB significantly lowered the Federal Funds interest rate. This has led to many of the Company's loans which are tied to the prime rate of interest again having loan rate floors which are in effect as of September 30, 2008. In the three months ended September 30, 2008, the average yield on loans was 6.28% versus an average prime rate for the period of 5.00%, or a difference of a positive 128 basis points. In the three months ended September 30, 2007, the average yield on loans was 8.08% versus an average prime rate for the period of 8.18%, or a difference of a negative 10 basis points.

Interest income increased $742,000 as the result of higher average loan balances from $1.80 billion during the three months ended September 30, 2007 to $1.84 billion during the three months ended September 30, 2008. The higher average balance resulted principally from the Bank's increases in average balances in commercial real estate loans, one- to four-family and multifamily real estate loans and consumer loans, partially offset by lower average balances in construction loans and commercial business loans. The Bank's one- to four-family residential loan portfolio balance increased in 2007 and to date in 2008 due to increased production by the Bank's mortgage division. The Bank generally sells fixed-rate one- to four-family residential loans in the secondary market.

During the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007, interest income on loans decreased due to lower average interest rates, partially offset by higher average balances. Interest income decreased $22.1 million as the result of lower average interest rates on loans. The average yield on loans decreased from 8.18% during the nine months ended September 30, 2007, to 6.57% during the nine months ended September 30, 2008. A large portion of the Bank's loan portfolio adjusts with changes to the "prime rate" of interest, as discussed above. In the nine months ended September 30, 2008, the average yield on loans was 6.57% versus an average prime rate for the period of 5.44%, or a difference of a positive 113 basis points. In the nine months ended September 30, 2007, the average yield on loans was 8.18% versus an average prime rate for the period of 8.23%, or a difference of a negative 5 basis points.

Interest income increased $6.0 million as the result of higher average loan balances from $1.76 billion during the nine months ended September 30, 2007 to $1.86 billion during the nine months ended September 30, 2008. The higher average balance resulted principally from the Bank's increases in average balances in commercial real estate loans, one- to four-family and multifamily real estate loans and consumer loans. The Bank's one- to four-family residential loan portfolio balance increased in 2007 and to date in 2008 due to increased production by the Bank's mortgage division. The Bank generally sells fixed-rate one- to four-family residential loans in the secondary market.

Interest Income - Investments and Other Interest-earning Assets

Interest income on investments and other interest-earning assets increased $692,000, mainly as a result of higher average balances, partially offset by lower average rates of interest, during the three months ended September 30, 2008, when compared to the three months ended September 30, 2007. Interest income increased $849,000 as a result of an increase in average balances from $427 million during the three months ended September 30, 2007, to $498 million during the

three months ended September 30, 2008. Interest income decreased $157,000 as a result of a decrease in average rates from 4.96% during the three months ended September 30, 2007, to 4.82% during the three months ended September 30, 2008. In 2005 and 2006, as principal balances on mortgage-backed securities were paid down through prepayments and normal amortization, the Company replaced a large portion of these securities with variable-rate mortgage-backed securities (primarily one-year and hybrid ARMs) which had a lower yield at the time of purchase relative to the fixed-rate securities remaining in the portfolio. As these securities reached interest rate reset dates in 2007, their rates typically have increased along with market interest rate increases. As market interest rates (primarily treasury rates and LIBOR rates) have generally declined from 2007 levels, the interest rates on those securities that reprice in 2008 likely will not increase and some could decrease at their next interest rate reset date. The actual amount of securities that will reprice and the actual interest rate changes on these securities is subject to the level of prepayments on these securities and the changes that actually occur in market interest rates (primarily treasury rates and LIBOR rates). The increase in average balances of investment securities in the first nine months of 2008 was primarily in available-for-sale mortgage-backed securities, where securities were needed for liquidity and pledging to deposit accounts under customer repurchase agreements and public fund deposits. The majority of these added securities are backed by hybrid ARMs which will have fixed rates of interest for a period of time (generally five to ten years) and then will adjust annually. In addition, the Company has several agency securities that are callable at the option of the issuer. Many of these securities were called in the first half of 2008, so the balance of U. S. Government agency securities has decreased. It is possible that, if market interest rates decline, agency security balances may be reduced further in 2008. The actual amount of securities that will reprice and the actual interest rate changes on these securities is subject to the level of prepayments on these securities and the changes that actually occur in market interest rates (primarily treasury rates and LIBOR rates). The Company had total variable-rate mortgage-backed securities of approximately $234 million at September 30, 2008.

Interest income on investments and other interest-earning assets increased $2.0 million, mainly as a result of higher average balances, partially offset by lower average rates of interest, during the nine months ended September 30, 2008, when compared to the nine months ended September 30, 2007. Interest income increased $2.2 million as a result of an increase in average balances from $430 million during the nine months ended September 30, 2007, to $491 million during the nine months ended September 30, 2008. Interest income decreased $231,000 as a result of a decrease in average rates from 4.87% during the nine months ended September 30, 2007, to 4.79% during the nine months ended September 30, 2008.

Total Interest Expense

Including the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, total interest expense decreased $7.4 million, or 30.7%, during the three months ended September 30, 2008, when compared with the three months ended September 30, 2007, primarily due to a decrease in interest expense on deposits of $6.2 million, or 31.0%, a decrease in interest expense on short-term borrowings and structured repo of $444,000, or 23.2%, a decrease in interest expense on FHLBank advances of $598,000, or 34.4%, and a decrease in interest expense on subordinated debentures issued to capital trust of $186,000, or 35.6%.

30

Excluding the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, total interest expense decreased $7.3 million, or 30.7%, during the three months ended September 30, 2008, when compared with the three months ended September 30, 2007, primarily due to a decrease in interest expense on deposits of $6.1 million, or 31.0%, a decrease in interest expense on short-term borrowings and structured repo of $444,000, or 23.2%, a decrease in interest expense on FHLBank advances of $598,000, or 34.4%, and a decrease in interest expense on subordinated debentures issued to capital trust of $186,000, or 35.6%.

Including the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, total interest expense decreased $14.8 million, or 21.3%, during the nine months ended September 30, 2008, when compared with the nine months ended September 30, 2007, primarily due to a decrease in interest expense on deposits of $12.0 million, or 20.9%, a decrease in interest expense on short-term borrowings and structured repo of $1.3 million, or 23.7%, a decrease in interest expense on FHLBank advances of $1.2 million, or 23.7%, and a decrease in interest expense on subordinated debentures issued to capital trust of $305,000, or 21.8%.

Excluding the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, total interest expense decreased $16.6 million, or 24.2%, during the nine months ended September 30, 2008, when compared with the nine months ended September 30, 2007, primarily due to a decrease in interest expense on deposits of $13.8 million, or 24.4%, a decrease in interest expense on short-term borrowings and structured repo of $1.3 million, or 23.7%, a decrease in interest expense on FHLBank advances of $1.2 million, or 23.7%, and a decrease in interest expense on subordinated debentures issued to capital trust of $305,000, or 21.8%.

The amortization of the deposit broker origination fees which were originally recorded as part of the 2005 accounting change regarding interest rate swaps significantly increased interest expense in both the first and second quarters of 2008, but did not have a significant effect in the third quarter of 2008. The amortization of these fees totaled $139,000 and $206,000 in the three months ended September 30, 2008 and 2007, respectively, and $2.5 million and $649,000 in the nine months ended September 30, 2008 and 2007, respectively. The Company expects that this fee amortization will be significantly less in the remainder of 2008 and thereafter, as fewer interest rate swaps remain and they are not as likely to be called. At September 30, 2008, the Company had $1.0 million of the original $6.5 million of the deposit broker origination fees which were originally recorded as part of the 2005 accounting change regarding interest rate swaps left to amortize in interest expense in future periods.

Interest Expense - Deposits

Including the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, interest on demand deposits decreased $2.2 million due to a decrease in average rates from 3.51% during the three months ended September 30, 2007, to 1.50% during the three months ended September 30, 2008. The average interest rates decreased due to lower overall market rates of interest throughout the fourth quarter of 2007 and the first nine months of 2008. Market rates of interest on checking and money market accounts began to decrease in the

31

fourth quarter of 2007 as the FRB reduced short-term interest rates. These FRB reductions have now continued into the fourth quarter of 2008. Interest on demand deposits decreased $540,000 due to a decrease in average balances from $491 million during the three months ended September 30, 2007, to $436 million during the three months ended September 30, 2008. Average noninterest-bearing demand balances decreased from $167 million in the three months ended September 30, 2007, to $147 million in the three months ended September 30, 2008.

Interest expense on deposits decreased $5.1 million as a result of a decrease in average rates of interest on time deposits from 5.40% during the three months ended September 30, 2007, to 3.77% during the three months ended September 30, 2008. This average rate of interest included the amortization of the deposit broker origination fees discussed above. Interest expense on deposits increased $1.6 million due to an increase in average balances of time deposits from $1.14 billion during the three months ended September 30, 2007, to $1.27 billion during the three months ended September 30, 2008. Market rates of interest on new certificates decreased since 2007 as the FRB reduced short-term interest rates. In addition, the Company's interest rate swaps repriced to lower rates in conjunction with the decreases in market interest rates in the first nine months of 2008.

The effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps did not impact interest on demand deposits.

Excluding the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, economically, interest expense on deposits decreased $5.0 million as a result of a decrease in average rates of interest on time deposits from 5.33% during the three months ended September 30, 2007, to 3.72% during the three months ended September 30, 2008. Interest expense on deposits also increased $1.6 million due to an increase in average balances of time deposits from $1.14 billion during the three months ended September 30, 2007, to $1.27 billion during the three months ended September 30, 2008.

Including the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, interest on demand deposits decreased $6.1 million due to a decrease in average rates from 3.43% during the nine months ended September 30, 2007, to 1.84% during the nine months ended September 30, 2008. The average rates of interest decreased due to lower overall market rates of interest throughout the fourth quarter of 2007 and the first nine months of 2008. Market rates of interest on checking and money market accounts began to decrease in the fourth quarter of 2007 as the FRB reduced short-term interest rates. These FRB reductions have now continued into the fourth quarter of 2008. Interest on demand deposits increased $1.1 million due to an increase in average balances from $470 million during the nine months ended September 30, 2007, to $517 million during the nine months ended September 30, 2008. Average noninterest-bearing demand balances decreased from $171 million in the nine months ended September 30, 2007, to $149 million in the nine months ended September 30, 2008.

Interest expense on deposits decreased $10.2 million as a result of a decrease in average rates of interest on time deposits from 5.34% during the nine months ended September 30, 2007, to 4.20% during the nine months ended September 30, 2008. This average rate of interest included the amortization of the deposit broker origination fees discussed above. Interest expense on deposits increased $3.1 million due to an increase in average balances of time deposits from

$1.14 billion during the nine months ended September 30, 2007, to $1.22 billion during the nine months ended September 30, 2008. Market rates of interest on new certificates decreased since 2007 as the FRB reduced short-term interest rates. In addition, the Company's interest rate swaps repriced to lower rates in conjunction with the decreases in market interest rates in the first nine months of 2008.

Excluding the effects of the Company's accounting entries recorded in 2008 and 2007 for certain interest rate swaps, economically, interest expense on deposits decreased $11.9 million as a result of a decrease in average rates of interest on time deposits from 5.26% during the nine months ended September 30, 2007, to 3.93% during the nine months ended September 30, 2008. Interest expense on deposits also increased $3.1 million due to an increase in average balances of time deposits from $1.14 billion during the nine months ended September 30, 2007, to $1.22 billion during the nine months ended September 30, 2008.

Interest Expense - FHLBank Advances, Short-term Borrowings and Structured Repo Borrowings and Subordinated Debentures Issued to Capital Trust

During the three months ended September 30, 2008 compared to the three months ended September 30, 2007, interest expense on FHLBank advances decreased primarily due to lower average interest rates. Interest expense on FHLBank advances decreased $316,000 due to a decrease in average interest rates from 4.87% in the three months ended September 30, 2007, to 3.69% in the three months ended September 30, 2008. Rates on advances decreased as the Company employed advances which matured in a relatively short term and advances which are indexed to one-month LIBOR and adjust monthly, taking advantage of the falling interest rate environment. Interest expense on FHLBank advances decreased $282,000 due to a decrease in average balances from $142 million during the three months ended September 30, 2007, to $123 million during the three months ended September 30, 2008.

During the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007, interest expense on FHLBank advances decreased primarily due to lower average interest rates. Interest expense on FHLBank advances decreased $1.2 million due to a decrease in average interest rates from 4.93% in the nine months ended September 30, 2007, to 3.76% in the nine months ended September 30, 2008. Rates on advances decreased as the Company employed advances which matured in a relatively short term and advances which are indexed to one-month LIBOR and adjust monthly, taking advantage of the falling interest rate environment. Average balances of FHLBank advances were $137 million during both the nine months ended September 30, 2008 and 2007.

Interest expense on short-term and structured repo borrowings decreased $1.2 million due to a decrease in average rates on short-term borrowings from 4.37% in the three months ended September 30, 2007, to 2.13% in the three months ended September 30, 2008. The average interest rates decreased due to lower overall market rates of interest in the third quarter of 2008 compared to the same period in 2007. Market rates of interest on short-term borrowings began to decrease in the fourth quarter of 2007 and continued to decrease through the third quarter of 2008 as the FRB has decreased short-term interest rates. Interest expense on short-term borrowings increased $802,000 due to an increase in average balances from $174 million during the three months ended September 30, 2007, to $276 million during the three months ended

33

September 30, 2008. The increase in balances of short-term borrowings was primarily due to the Company's use of borrowing lines available under the Federal Reserve's Term Auction Facility and increases in securities sold under repurchase agreements with the Company's deposit customers. In addition, in September 2008, the Company entered into a structured repo borrowing agreement totaling $50 million which bears interest at a fixed rate unless LIBOR exceeds 2.81%. If LIBOR exceeds 2.81%, the borrowing costs decrease by a multiple of the difference between LIBOR and 2.81%. This rate adjusts quarterly.

Interest expense on short-term and structured repo borrowings decreased $3.3 million due to a decrease in average rates on short-term borrowings from 4.45% in the nine months ended September 30, 2007, to 2.33% in the nine months ended September 30, 2008. The average interest rates decreased due to lower overall market rates of interest in the first nine months of 2008 compared to the same period in 2007. Market rates of interest on short-term borrowings began to decrease in the fourth quarter of 2007 and continued to decrease through the first nine months of 2008 as the FRB has decreased short-term interest rates. Interest expense on short-term borrowings increased $2.0 million due to an increase in average balances from $168 million during the nine months ended September 30, 2007, to $244 million during the nine months ended September 30, 2008. The increase in balances of short-term borrowings was primarily due to the Company's use of borrowing lines available under the Federal Reserve's Term Auction Facility and increases in securities sold under repurchase agreements with the Company's deposit customers. In addition, in September 2008, the Company entered into a structured repo borrowing agreement totaling $50 million described above.

Interest expense on subordinated debentures issued to capital trust decreased $196,000 due to decreases in average rates from 6.83% in the three months ended September 30, 2007, to 4.32% in the three months ended September 30, 2008. As LIBOR rates decreased from the same period a year ago, the interest rates on these instruments also adjusted lower. Interest expense on subordinated debentures issued to capital trust increased $10,000 due to a slight increases in average balances from $30 million in the three months ended September 30, 2007, to $31 million in the three months ended September 30, 2008. In July 2007, the Company issued $5 million of new trust preferred debentures, increasing the amount of trust preferred debentures outstanding.

Interest expense on subordinated debentures issued to capital trust decreased $475,000 due to decreases in average rates from 6.86% in the nine months ended September 30, 2007, to 4.74% in the nine months ended September 30, 2008. As LIBOR rates decreased from the same period a year ago, the interest rates on these instruments also adjusted lower. Interest expense on subordinated debentures issued to capital trust increased $170,000 due to increases in average balances from $27 million in the nine months ended September 30, 2007, to $31 million in the nine months ended September 30, 2008. In July 2007, the Company issued $5 million of new trust preferred debentures, increasing the amount of trust preferred debentures outstanding.

Net Interest Income

Including the effects of the Company's accounting entries recorded for certain interest rate swaps in 2008 and 2007, the Company's overall average interest rate spread increased 21 basis points, or 7.9%, from 2.66% during the three months ended September 30, 2007, to 2.87% during the three months ended September 30, 2008. Changes in the average interest rate spread included a 173 basis point decrease in the weighted average rate paid on interest-bearing liabilities, partially offset by a 152 basis point decrease in the weighted average yield received on interest-earning assets. The Company's overall net interest margin decreased 7 basis points, or 2.2%, from 3.20% during the three months ended September 30, 2007, to 3.13% during the three months ended September 30, 2008. In comparing the two periods, the yield on loans decreased 180 basis points while the yield on investment securities and other interest-earning assets decreased 14 basis points. The rate paid on deposits decreased 164 basis points, the rate paid on FHLBank advances decreased 118 basis points, the rate paid on short-term and structured repo borrowings decreased 224 basis points, and the rate paid on subordinated debentures issued to capital trust decreased 251 basis points. The rate paid on deposits was affected by the amortization of the deposit broker origination fees discussed above.

The prime rate of interest averaged 8.18% during the three months ended September 30, 2007, compared to an average of 5.00% during the three months ended September 30, 2008. The prime rate began to decrease in the latter half of 2007 as the FRB began to lower short-term interest rates, and stood at 5.00% at September 30, 2008. A large percentage of the Bank's loans are indexed to the prime rate of interest, which resulted in decreased loan yields in 2008 compared to 2007.

Interest rates paid on deposits, FHLBank advances, short-term borrowings and subordinated debentures were significantly lower in the three months ended September 30, 2008 compared to the 2007 period. Interest costs on these liabilities began to decrease in the latter half of 2007 and throughout the first nine months of 2008 as a result of declining short-term market interest rates, primarily due to decreases by the FRB. The Company continues to utilize (although currently to a significantly lesser degree) interest rate swaps and FHLBank advances that reprice frequently to manage overall interest rate risk. See "Quantitative and Qualitative Disclosures About Market Risk" for additional information on the Company's interest rate swaps.

Excluding the effects of the Company's accounting entries recorded for certain interest rate swaps in 2008 and 2007, the Company's overall average interest rate spread increased 20 basis points, or 7.4%, from 2.70% during the three months ended September 30, 2007, to 2.90% during the three months ended September 30, 2008. The increase was due to a 171 basis point decrease in the weighted average rate paid on interest-bearing liabilities, partially offset by a 152 basis point decrease in the weighted average yield received on interest-earning assets. The Company's overall net interest margin decreased 8 basis points, or 2.5%, from 3.23% during the three months ended September 30, 2007, to 3.15% during the three months ended September 30, 2008. In comparing the two periods, the yield on loans decreased 180 basis points while the yield on investment securities and other interest-earning assets decreased 14 basis points. The rate paid on deposits decreased 162 basis points, the rate paid on FHLBank advances decreased 118 basis points, the rate paid on short-term and structured repo borrowings decreased 224 basis points, and the rate paid on subordinated debentures issued to capital trust decreased 251 basis points.

Including the effects of the Company's accounting entries recorded for certain interest rate swaps in 2008 and 2007, the Company's overall average interest rate spread increased 6 basis points from 2.74% during the nine months ended September 30, 2007 to 2.80% during the nine months ended September 30, 2008. Changes in the average interest rate spread included a 139 basis point decrease in the weighted average rate paid on interest-bearing liabilities, partially offset by a 133 basis point decrease in the weighted average yield received on interest-earning assets. The Company's overall net interest margin decreased 19 basis points, or 5.8%, from 3.28% during the nine months ended September 30, 2007, to 3.09% during the nine months ended September 30, 2008. In comparing the two periods, the yield on loans decreased 161 basis points while the yield on investment securities and other interest-earning assets decreased 8 basis points. The rate paid on deposits decreased 128 basis points, the rate paid on FHLBank advances decreased 117 basis points, the rate paid on short-term and structured repo borrowings decreased 212 basis points, and the rate paid on subordinated debentures issued to capital trust decreased 212 basis points. The rate paid on deposits was affected by the amortization of the deposit broker origination fees discussed above.

The prime rate of interest averaged 8.23% during the nine months ended September 30, 2007, compared to an average of 5.44% during the nine months ended September 30, 2008. The prime rate began to decrease in the latter half of 2007 as the FRB began to lower short-term interest rates, and stood at 5.00% at September 30, 2008. A large percentage of the Bank's loans are indexed to the prime rate of interest, which resulted in decreased loan yields in 2008 compared to 2007.

Excluding the effects of the Company's accounting entries recorded for certain interest rate swaps in 2008 and 2007, the Company's overall average interest rate spread increased 17 basis points, or 6.1%, from 2.78% during the nine months ended September 30, 2007, to 2.95% during the nine months ended September 30, 2008. The increase was due to a 150 basis point decrease in the weighted average rate paid on interest-bearing liabilities, partially offset by a 133 basis point decrease in the weighted average yield received on interest-earning assets. The Company's overall net interest margin decreased 9 basis points, or 2.7%, from 3.32% during the nine months ended September 30, 2007, to 3.23% during the nine months ended September 30, 2008. In comparing the two periods, the yield on loans decreased 161 basis points while the yield on investment securities and other interest-earning assets decreased 8 basis points. The rate paid on deposits decreased 141 basis points, the rate paid on FHLBank advances decreased 117 basis points, the rate paid on short-term and structured repo borrowings decreased 212 basis points, and the rate paid on subordinated debentures issued to capital trust decreased 212 basis points.

Non-GAAP Reconciliation

(Dollars in thousands)

	Three Months Ended September 30,			
	2008		2007	
	$	%	$	%
Reported Net Interest Income/Margin	$ 18,367	3.13%	$ 17,932	3.20%
Amortization of deposit broker origination fees	139	.02	206	.03
Net interest income/margin excluding impact of hedge accounting entries	$ 18,506	3.15%	$ 18,138	3.23%

	Nine Months Ended September 30,			
	2008		2007	
	$	%	$	%
Reported Net Interest Income/Margin	$ 54,341	3.09%	$ 53,606	3.28%
Amortization of deposit broker origination fees	2,472	.14	649	.04
Net interest income/margin excluding impact of hedge accounting entries	$ 56,813	3.23%	$ 54,255	3.32%

For additional information on net interest income components, refer to "Average Balances, Interest Rates and Yields" table in this Quarterly Report on Form 10-Q. This table is prepared including the impact of the accounting changes for interest rate swaps.

Provision for Loan Losses and Allowance for Loan Losses

The provision for loan losses increased $3.1 million from $1.4 million during the three months ended September 30, 2007 to $4.5 million during the three months ended September 30, 2008. The allowance for loan losses increased $2.2 million, or 7.8%, to $29.4 million at September 30, 2008 compared to $27.2 million at June 30, 2008. Net charge-offs were $2.4 million in the three months ended September 30, 2008 versus $1.9 million in the three months ended September 30, 2007. The increases in charge-offs and foreclosed assets were due to general market conditions, and more specifically, housing supply, absorption rates and unique circumstances related to individual borrowers and projects. As properties were transferred into foreclosed assets, evaluations were made of the value of these assets with corresponding charge-offs as appropriate. Four relationships were responsible for $1.2 million of the total charge-offs in the three months ended September 30, 2008. Three of these relationships were transferred to non-performing loans, and the remaining one relationship was completely charged off.

The provision for loan losses increased $43.1 million from $4.1 million during the nine months ended September 30, 2007 to $47.2 million during the nine months ended September 30, 2008. The allowance for loan losses increased $3.9

million, or 15.4%, to $29.4 million at September 30, 2008 compared to $25.5 million at December 31, 2007. Net charge-offs were $43.3 million

37

in the nine months ended September 30, 2008 versus $4.3 million in the nine months ended September 30, 2007. The increase in charge-offs for the nine months ended September 30, 2008, was due principally to the $35 million which was provided for and charged off in the quarter ended March 31, 2008, related to the Company's loans to the Arkansas-based bank holding company and related loans to individuals described in the Company's Quarterly Report on Form 10-Q for March 31, 2008. In addition, general market conditions, and more specifically, housing supply, absorption rates and unique circumstances related to individual borrowers and projects also contributed to increased provisions. As properties were transferred into foreclosed assets, evaluations were made of the value of these assets with corresponding charge-offs as appropriate.

Management records a provision for loan losses in an amount it believes sufficient to result in an allowance for loan losses that will cover current net charge-offs as well as risks believed to be inherent in the loan portfolio of the Bank. The amount of provision charged against current income is based on several factors, including, but not limited to, past loss experience, current portfolio mix, actual and potential losses identified in the loan portfolio, economic conditions, regular reviews by internal staff and regulatory examinations.

Weak economic conditions, higher inflation or interest rates, or other factors may lead to increased losses in the portfolio and/or requirements for an increase in loan loss provision expense. Management has established various controls in an attempt to limit future losses, such as a watch list of possible problem loans, documented loan administration policies and a loan review staff to review the quality and anticipated collectability of the portfolio. Management determines which loans are potentially uncollectible, or represent a greater risk of loss, and makes additional provisions to expense, if necessary, to maintain the allowance at a satisfactory level.

The Bank's allowance for loan losses as a percentage of total loans was 1.63%, 1.49% and 1.38% at September 30, 2008, June 30, 2008, and December 31, 2007, respectively. Management considers the allowance for loan losses adequate to cover losses inherent in the Company's loan portfolio at this time, based on recent internal and external reviews of the Company's loan portfolio and current economic conditions. If economic conditions remain weak or deteriorate significantly, it is possible that additional loan loss provisions would be required, thereby adversely affecting future results of operations and financial condition. The Company expects loan loss provisions, non-performing loans and foreclosed assets to remain elevated.

Non-performing Assets

As a result of changes in balances and composition of the loan portfolio, changes in economic and market conditions that occur from time to time, and other factors specific to a borrower's circumstances, the level of non-performing assets will fluctuate. Non-performing assets at September 30, 2008, were $66.0 million, up $10.1 million from December 31, 2007 and up $0.1 million from June 30, 2008. Non-performing assets as a percentage of total assets were 2.61% at September 30, 2008, compared to 2.30% at December 31, 2007, and 2.65% at June 30, 2008. Compared to December 31, 2007, non-performing loans decreased $2.3 million to $33.2 million while foreclosed assets increased $12.4 million to $32.8 million. Commercial real estate, construction and business loans comprised $30.1 million, or 91%, of the total $33.2 million of non-performing loans at September 30, 2008.

Non-performing Loans. Compared to December 31, 2007, non-performing loans decreased $2.3 million to $33.2 million. Increases in non-performing loans during the nine months ended September 30, 2008, were primarily due to the addition of eleven loan relationships to the Non-performing Loans category. Two of these relationships were subsequently transferred to foreclosed assets by September 30, 2008, one relationship was paid off by September 30, 2008, and eight of these relationships remain in the Non-performing Loans category:

- A $1.7 million loan relationship, which was previously secured by a stock investment in a bank holding company, and is currently secured by anticipated tax refunds, interests in various business ventures and other collateral. A charge-off of approximately $5.1 million was recorded upon the transfer of the relationship to Non-Performing Loans. This relationship was described in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets – Subsequent Event Regarding Potential Problem Loans." This relationship was reduced $1.0 million, to $687,000, during the third quarter of 2008 through receipt of a portion of the anticipated tax refunds. This relationship remains in the Non-Performing Loans category at September 30, 2008. In November 2008, the Company received a payment from the borrower which reduced the outstanding balance of this relationship to $-0-.

- A $1.7 million loan relationship, which involves a retail/office rehabilitation project in the St. Louis metropolitan area, was added to Non-Performing Loans in the first quarter of 2008. This relationship was transferred to foreclosed assets during the second quarter of 2008 and remains in foreclosed assets at September 30, 2008. A charge-off of approximately $1.0 million was recorded upon the transfer of the relationship to foreclosed assets. Renovations to the building are not complete. The Company will likely attempt to sell the building "as is" instead of completing the renovations.

- A $2.7 million loan relationship, which is secured primarily by a motel in the State of Florida. This motel has operated for several years; however, it has been experiencing cash flow problems for a while, resulting in inconsistent payment performance. This relationship was described in the Company's 2007 Annual Report on Form 10-K under "Potential Problem Loans." The primary collateral was sold by the borrower during the third quarter of 2008. The Company received a principal reduction on the debt and financed the new owner.

- A $2.3 million loan relationship, which is secured primarily by commercial land and acreage to be developed into commercial lots in Northwest Arkansas. This relationship was described in the Company's March 31, 2008 Quarterly Report on Form 10-Q under "Potential Problem Loans." This relationship remains in the Non-Performing Loans category at September 30, 2008.

- A $1.2 million loan relationship, which is secured primarily by vacant commercial land and a duplex development in Northwest Arkansas. This relationship was described in the Company's March 31, 2008 Quarterly Report on Form 10-Q under "Potential Problem Loans." A charge-off of approximately $440,000 was recorded during the third quarter of 2008, reducing the relationship balance to $770,000. This relationship remains in the Non-Performing Loans category at September 30, 2008.

- A $952,000 loan relationship, which was previously secured by a stock investment in a bank holding company, and is currently secured primarily by interests in various business ventures, agricultural ground, as well as other assets. A charge-off of approximately $1.5 million was recorded upon the transfer of the relationship to Non-Performing Loans. This relationship was described in the Company's March 31, 2008 Quarterly Report on Form 10-Q under "Potential Problem Loans." This relationship was reduced $180,000, to $772,000, during the third quarter of 2008 through receipt of payments from the borrower. This relationship remains in the Non-Performing Loans category at September 30, 2008.

- A $900,000 loan relationship, which is secured primarily by completed houses used as rental properties in Springfield. The primary collateral was foreclosed during the third quarter of 2008. These houses were subsequently sold.

- A $2.5 million loan relationship, which is secured primarily by an office and residential historic rehabilitation project in St. Louis. This relationship was charged down approximately $250,000 upon transfer to non-performing loans in the third quarter of 2008. This relationship remains in the Non-Performing Loans category at September 30, 2008.

- A $3.0 million loan relationship, which is secured primarily by a condominium development in Kansas City. Some sales occurred during 2007, with the outstanding balance decreasing $1.9 million in 2007. However, no sales have occurred in 2008. This relationship was charged down approximately $285,000 upon transfer to non-performing loans in the third quarter of 2008. This relationship remains in the Non-Performing Loans category at September 30, 2008.

- A $1.9 million loan relationship, which is secured primarily by a residential subdivision development and developed lots in various subdivisions in Springfield, Mo. This relationship remains in the Non-Performing Loans category at September 30, 2008.

- A $1.2 million loan relationship, which is primarily secured by lots, houses and duplexes for resale in the Joplin, Mo., area. This relationship remains in the Non-Performing Loans category at September 30, 2008.

Decreases in non-performing loans during the nine months ended September 30, 2008, were:

- A $4.4 million loan relationship, which involves an office and retail historic rehabilitation development in southeast Missouri, was transferred to foreclosed assets during the second quarter of 2008. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets." The carrying balance of the asset was reduced as a result of a $500,000 payment made by an investor in this project. This building is primarily leased to a government entity and the lease revenue, which the Company receives, provides a positive cash flow to the project. This asset is now carried in foreclosed assets at a book value of $3.9 million. While this asset is included in the Company's Non-Performing Asset totals and ratios, the Company does not consider it to be a "Substandard Asset" as it produces a market return on the amount invested.

- A $1.2 million loan relationship, which involves an office and retail historic rehabilitation development in southwest Missouri, was transferred to foreclosed assets during the second quarter of 2008. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets." The carrying balance of the asset was reduced as a result of a $50,000 payment made by an investor in this project and a charge-off of $100,000 at the time of foreclosure. This building is partially leased to a government entity and the lease revenue, which the Company receives, provides some cash flow to the project. This asset is now carried in foreclosed assets at a book value of $940,000. The Company has entered into a contract to sell the property and recorded a write-down on the asset of $110,000 in September 2008 in anticipation of the sale.

- A $3.3 million loan relationship, which was secured by a nursing home in the State of Missouri, was paid off in the first quarter of 2008 upon the sale of the facility. The Company had previously recorded a charge to the allowance for loan losses regarding this relationship and recovered approximately $500,000 to the allowance upon receipt of the loan payoff. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets."

- A portion of the primary collateral underlying a $2.6 million loan relationship, the borrowers' interest in a publicly regulated entity, was sold by the borrower during the third quarter of 2008. The borrower sold a two-thirds interest in the entity and the new owner assumed the debt to the Company.

- A $1.0 million loan relationship, which involves subdivision lots and houses in central Missouri, was foreclosed upon during the first quarter of 2008. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets."

- A $1.9 million loan relationship, which involves partially-developed subdivision lots in Northwest Arkansas, was foreclosed upon during the second quarter of 2008. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets."

- A $1.3 million loan relationship, which involves a restaurant building in Northwest Arkansas, was foreclosed upon during the second quarter of 2008. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets." The Company is currently negotiating with an interested buyer to sell this property.

- A $1.3 million loan relationship, which involves several completed houses in the Branson, Mo., area, was foreclosed upon during the second quarter of 2008. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets." At September 30, 2008, this relationship was recorded in foreclosed assets at $1.1 million after a $200,000 write-down in the second quarter of 2008. The Company has a portion of the properties under contract to sell which will reduce the relationship balance by $219,000.

At September 30, 2008, six loan relationships in excess of $1 million accounted for $20.0 million of the total non-performing loan balance of $33.2 million. In addition to the five relationships in excess of $1 million noted above, one other significant loan relationship was included in Non-performing Loans at December 31, 2007, and remained there at September 30, 2008. This relationship is described below:

- A $9.2 million loan relationship, which is secured by a condominium and retail historic rehabilitation development in St. Louis. The original relationship has been reduced through the receipt of a portion of the Federal and State historic tax credits expected to be received by the Company in 2008. Upon receipt of additional Federal and State tax credits, the Company expects to reduce the balance of this relationship to approximately $5.0 million, the value of which is substantiated by a recent appraisal. In October 2008, the balance outstanding was reduced $1.4 million due to receipt of Tax Increment Financing funds. The Company expects to remove this relationship from loans and hold it as a real estate asset once the tax credit process is completed. To date, five of the ten residential units are leased. The retail space is not leased at this time. This relationship was described more fully in the Company's 2007 Annual Report on Form 10-K under "Non-performing Assets."

Foreclosed Assets. Of the total $32.8 million of foreclosed assets at September 30, 2008, foreclosed real estate totaled $32.4 million and repossessed automobiles, boats and other personal property totaled $405,000. Foreclosed assets increased $12.4 million during the nine months ended September 30, 2008, from $20.4 million at December 31, 2007, to $32.8 million at September 30, 2008. During the nine months ended September 30, 2008, foreclosed assets increased primarily due to the addition of eight significant relationships (five of which remain in foreclosed assets) to the foreclosed assets category and the addition of several smaller relationships that involve houses which are completed and for sale or under construction, as well as developed subdivision lots, partially offset by the sale of similar houses and subdivision lots. Partially offsetting these additions to foreclosed assets, the Company sold a motel located in the State of Illinois. This relationship totaled $2.6 million. The eight relationships added to foreclosed assets were described above in "Non-Performing Loans."

At September 30, 2008, ten separate relationships in excess of $1 million comprise $22.1 million, or 67%, of the total foreclosed assets balance. In addition to the five relationships described above which remain in foreclosed assets at September 30, 2008, the other five relationships include:

- A $3.4 million asset relationship, discussed in previous filings as a $4.2 million relationship, which involves two residential developments in the Kansas City, Mo., metropolitan area. The Company recorded a write-down on this relationship of $0.8 million through expenses on foreclosed assets in the third quarter of 2008. These two subdivisions are primarily comprised of developed lots with some additional undeveloped ground. The Company has marketed these projects and has seen some recent interest by prospective purchasers. One of the subdivisions is now under contract to sell which will reduce the relationship balance by $1.3 million.

- A $3.3 million asset relationship, which involves a residential development in the St. Louis, Mo., metropolitan area. This St. Louis area relationship was foreclosed in the first quarter 2008. The Company recorded a loan charge-off of $1.0 million at the time of transfer to foreclosed assets based upon updated valuations of the assets. The Company is pursuing collection efforts against the guarantors on this credit. This relationship was described more fully in the Company’s 2007 Annual Report on Form 10-K under “Potential Problem Loans.”

- A $3.0 million asset relationship, which involves residential developments in Northwest Arkansas. One of the developments is comprised of completed houses and additional lots. The second development is comprised of completed duplexes and triplexes. A few sales of single-family houses have occurred and the remaining properties are being marketed for sale. The Company has a portion of the properties under contract to sell which will reduce the relationship balance by $375,000.

- A $1.8 million asset relationship, which involves a residence and commercial building in the Lake of the Ozarks, Mo., area. The Company is marketing these properties for sale.

- A $1.5 million relationship, which involves residential developments, primarily residential lots in three different subdivisions and undeveloped ground, in the Branson, Mo., area. The Company is marketing these properties for sale.

Potential Problem Loans. Potential problem loans decreased $14.3 million during the nine months ended September 30, 2008, from $30.4 million at December 31, 2007, to $16.1 million at September 30, 2008. Potential problem loans are loans which management has identified as having possible credit problems that may cause the borrowers difficulty in complying with current repayment terms. These loans are not reflected in non-performing assets. During the nine months ended September 30, 2008, Potential Problem Loans increased primarily due to the addition of five unrelated relationships totaling $9.2 million to the Potential Problem Loans category. These five additional relationships include: a $3.0 million office and residential historic rehabilitation project in St. Louis (subsequently moved to Non-Performing Loans category at $2.5 million); a $2.5 million relationship primarily secured by an office building and vacant land to be used for commercial development in Springfield, Mo. (described below); a $1.2 million

relationship primarily secured by eight single-family houses which were constructed for sale in Northwest Arkansas (described below); a $1.3 million relationship primarily secured by lots, houses and duplexes for resale in the Joplin, Mo., area (subsequently moved to Non-Performing Loans category); and a $1.2 million relationship primarily secured by subdivision lots and houses for resale in Joplin (subsequently reduced to less than $1 million). Decreases in Potential Problem Loans resulted from charge-offs totaling $2.6 million and the transfer of various relationships described above to foreclosed assets and non-performing loans. In addition, one $4.6 million relationship was removed from the Potential Problem Loans category and returned to performing status due to an ownership change in the project, which added equity to the project as well as additional guarantor support, and a reduction of $562,000 from the sale of a portion of the collateral.

At September 30, 2008, five significant relationships accounted for $10.3 million of the potential problem loan total of $16.1 million. These five relationships include:

- The first loan relationship totaled $2.5 million and consists of an office building and vacant land to be used for commercial development in the Springfield, Mo. area. The borrower has additional income producing properties that provide some excess cash flow to support these projects at this time.

- The second loan relationship totaled $1.2 million and is primarily secured by eight single-family houses which were constructed for sale in Northwest Arkansas. The borrower had constructed and sold several homes in the subdivision, but sales have now slowed considerably and the borrower is experiencing significant difficulty in complying with current repayment terms.

- The third loan relationship totaled $1.5 million. The relationship is secured primarily by a retail center, developed and undeveloped residential subdivisions, and single-family houses in the Springfield, Missouri, area. The single-family houses are leased and provide some cash flow for the loans.

- The fourth loan relationship consists of a retail center, improved commercial land and other collateral in the states of Georgia and Texas totaling $3.3 million. During the first quarter of 2008, performance on the relationship improved and the Company obtained additional collateral; however, the Company still considers this relationship as having possible credit problems that may cause the borrowers difficulty in complying with current repayment terms.

- The fifth loan relationship totaled $1.9 million and consists of a residential subdivision development in Springfield, Mo. The site improvements are now essentially completed and the lot sales program has been restarted.

Non-interest Income

Including the effects of the Company's accounting entries recorded for certain interest rate swaps in 2008 and 2007, total non-interest income decreased $5.8 million in the three months ended September 30, 2008 when compared to the three months ended September 30, 2007. Non-interest

income for the third quarter of 2008 was $1.8 million compared with $7.6 million for the third quarter 2007. This decrease in non-interest income was primarily the result of the impairment write-down in value of the Company's investments in available-for-sale Fannie Mae and Freddie Mac perpetual preferred stock. This write-down totaled $5.3 million on a pre-tax basis. As previously reported in the Company's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2008, the Company's investments in Fannie Mae and Freddie Mac securities were included in securities available for sale at a cost of $4.0 million and $1.8 million, respectively. These securities have recently traded at 5 to 10 percent of par value and are currently not expected to pay dividends. It is unclear if or when the values of such investment securities will improve, or whether such values will deteriorate further. Based on these developments, the Company recorded an other-than-temporary impairment. The Company does not own any other equity securities issued by Fannie Mae or Freddie Mac.

Excluding the securities loss discussed above, non-interest income for the third quarter of 2008 was $7.1 million compared with $7.6 million for the third quarter of 2007, or a decrease of $491,000. Third quarter 2008 commission income from the Company's travel, insurance and investment divisions decreased $471,000, or 19.3%, compared to the same period in 2007. Part of this decrease was in the investment division as a result of the alliance formed with Ameriprise Financial Services through Penney, Murray and Associates. As a result of this change, Great Southern now records most of its investment services activity on a net basis in non-interest income. Thus, non-interest expense related to the investment services division is also reduced. The Company's travel division also experienced a decrease in commission income. Customers are reducing their travel in light of current economic conditions. The net realized gains on loan sales increased $122,000, or 49.4%, in the third quarter of 2008 compared to the third quarter of 2007. The gain on loan sales was mainly due to a higher volume of fixed-rate residential mortgage loan originations, which the Company typically sells in the secondary market. Income from charges on deposit accounts and fees from ATM and debit card usage increased $250,000, or 6.5%, in the three months ended September 30, 2008 compared to the same period in 2007. Late charges and other fees on loans decreased $111,000 in the three months ended September 30, 2008 compared to the same period in 2007. Non-interest income was also lower due to the change in the fair value of certain interest rate swaps and the related change in fair value of hedged deposits, which resulted in an increase of $32,000 in the three months ended September 30, 2008, and an increase of $157,000 in the three months ended September 30, 2007.

Including the securities loss discussed above, non-interest income for the nine months ended September 30, 2008 was $21.8 million compared with $22.5 million for the same period in 2007, or a decrease of $667,000. Excluding the securities loss discussed above, non-interest income for the first nine months of 2008 was $27.1 million compared with $22.5 million for the first nine months of 2007, or an increase of $4.6 million. A significant portion of this increase in non-interest income was due to the change in the fair value of certain interest rate swaps and the related change in fair value of hedged deposits, which resulted in an increase of $5.3 million in the nine months ended September 30, 2008, and an increase of $843,000 in the nine months ended September 30, 2007. Excluding the effects of the interest rate swap-related entries and the securities loss, non-interest income was $21.8 million in the nine months ended September 30, 2008, compared to $21.7 million in the nine months ended September 30, 2007. Year-to-date September 30, 2008, commission income from the Company's travel, insurance and investment

divisions decreased $629,000, or 8.2%, compared to the same period in 2007. This decrease was primarily in the investment division as a result of the alliance formed with Ameriprise Financial Services described above. The Company's travel division also experienced a decrease in commission income as discussed above. The net realized gains on loan sales increased $445,000, or 65.2%, in the nine months ended September 30, 2008, compared to the same period in 2007. The gain on loan sales was mainly due to a higher volume of fixed-rate residential mortgage loan originations, which the Company typically sells in the secondary market. Income from charges on deposit accounts and fees from ATM and debit card usage increased $333,000, or 3.0%, in the nine months ended September 30, 2008, compared to the same period in 2007.

Non-interest Expense

Total non-interest expense increased $1.3 million, or 10.0%, from $13.3 million in the three months ended September 30, 2007, to $14.6 million in the three months ended September 30, 2008. The increase was primarily due to: (i) an increase of $1.7 million, or 1,394.4%, in expense on foreclosed assets; (ii) an increase of $230,000, or 80.7%, in legal and professional fees, primarily related to credit and foreclosure matters; and (iii) smaller increases and decreases in other non-interest expense areas, such as postage, occupancy, insurance, supplies and telephone. Partially offsetting these increases, salaries and employee benefits decreased $183,000, or 2.4%, and advertising expense decreased $108,000, or 30.4%.

Total non-interest expense increased $4.3 million, or 11.4%, from $38.0 million in the nine months ended September 30, 2007, to $42.3 million in the nine months ended September 30, 2008. The increase was primarily due to: (i) an increase of $2.2 million, or 803.3%, in expense on foreclosed assets; (ii) an increase of $369,000, or 42.6%, in legal and professional fees, primarily related to credit and foreclosure matters; (iii) an increase of $1.4 million, or 6.4%, in salaries and employee benefits; (iv) an increase of $678,000, or 68.9%, in insurance expense; (v) an increase of $368,000, or 6.3%, in occupancy and equipment expense; and (vi) smaller increases and decreases in other non-interest expense areas, such as postage, advertising, telephone and supplies.

In 2007, the Federal Deposit Insurance Corporation (FDIC) began to once again assess insurance premiums on insured institutions. Under the new pricing system, institutions in all risk categories, even the best rated, are charged an FDIC premium. Great Southern received a deposit insurance credit as a result of premiums previously paid. The Company's credit offset assessed premiums for the first half of 2007, but premiums were owed by the Company in the latter half of 2007 and into 2008. The Company currently expects a similar expense in subsequent quarters and expects that the FDIC will increase premiums for all institutions sometime in the future to replenish the FDIC’s deposit insurance fund.

Due to increases in the level of foreclosed assets, foreclosure-related expenses in the third quarter of 2008 were higher than the comparable 2007 period by approximately $1.7 million. Similarly, foreclosure-related expenses increased $2.2 million in the nine months ended September 30, 2008, compared to the same period in 2007. In the three months ended September 30, 2008, the Company recorded write-downs totaling approximately $1.1 million on four unrelated foreclosed properties. Two of these properties are under contract to be sold. The Company expects that expenses on foreclosed assets and expenses related to the credit resolution process will remain elevated.

In addition to the expense increases noted above, the Company's increase in non-interest expense in the first nine months of 2008 compared to the same period in 2007 related to the continued growth of the Company. Late in the first quarter of 2007, Great Southern completed its acquisition of a travel agency in St. Louis. In addition since June 2007, the Company opened banking centers in Springfield, Mo. and Branson, Mo. In the nine months ended September 30, 2008, compared to the nine months ended September 30, 2007, non-interest expenses increased $600,000 related to the ongoing operations of these entities.

The Company's efficiency ratio for the three months ended September 30, 2008, was 72.68% compared to 52.15% in the same quarter in 2007. The efficiency ratio in the third quarter 2008 and year-to-date was primarily negatively impacted by the investment write-down recorded by the Company. The third quarter 2008 efficiency ratio was also negatively impacted by increased expenses related to foreclosures. These efficiency ratios include the impact of the hedge accounting entries for certain interest rate swaps. Excluding the effects of these entries, the efficiency ratio for the third quarter of 2008 was 72.26% compared to 52.01% in the same period in 2007. The Company's ratio of non-interest expense to average assets decreased from 2.24% for the three months ended September 30, 2007, to 2.07% for the three months ended September 30, 2008, due to the Company's ongoing cost management efforts.

The Company's efficiency ratio for the nine months ended September 30, 2008, was 55.56% compared to 49.90% in the same period in 2007. The efficiency ratio in the nine months ended September 30, 2008, was negatively impacted by the investment write-down recorded by the Company. The 2008 period's efficiency ratio was also negatively impacted by increased expenses related to foreclosures. These efficiency ratios include the impact of the hedge accounting entries for certain interest rate swaps. Excluding the effects of these entries, the efficiency ratio for the first nine months of 2008 was 57.69% compared to 50.14% in the same period in 2007. The Company's ratio of non-interest expense to average assets decreased from 2.16% for the nine months ended September 30, 2007, to 2.13% for the nine months ended September 30, 2008.

Non-GAAP Reconciliation
(Dollars in thousands)

	Three Months Ended September 30,					
	2008			2007		
	Non-Interest Expense	Revenue Dollars*	%	Non-Interest Expense	Revenue Dollars*	%
Efficiency Ratio	$ 14,650	$ 20,156	72.68%	$ 13,320	$ 25,542	52.15%
Amortization of deposit broker origination fees	--	139	(.50)	--	206	(.42)
Net change in fair value of interest rate swaps and related deposits	--	(22)	.08	--	(139)	.28
Efficiency ratio excluding impact of hedge accounting entries	$ 14,650	$ 20,273	72.26%	$ 13,320	$ 25,609	52.01%

* Net interest income plus non-interest income.

	Nine Months Ended September 30,					
	2008			2007		
	Non-Interest Expense	Revenue Dollars*	%	Non-Interest Expense	Revenue Dollars*	%
Efficiency Ratio	$ 42,324	$ 76,177	55.56%	$ 37,980	$ 76,109	49.90%
Amortization of deposit broker origination fees	--	2,472	(1.87)	--	649	(.43)
Net change in fair value of interest rate swaps and related deposits	--	(5,285)	4.00	--	(1,008)	.67
Efficiency ratio excluding impact of hedge accounting entries	$ 42,324	$ 73,364	57.69%	$ 37,980	$ 75,750	50.14%

* Net interest income plus non-interest income.

Provision for Income Taxes

Provision for income taxes as a percentage of pre-tax income was 18.1% and 32.7% for the three months ended September 30, 2008 and 2007, respectively. For the three months ended September 30, 2008, the Company's effective tax rate was lower than normal primarily due to the lower pre-tax income during this period. Provision for income taxes as a percentage of pre-tax income was 32.8% for the nine months ended September 30, 2007. The Company’s effective tax benefit rate was 40.1% for the nine months ended September 30, 2008. For future periods in 2008, the Company expects the effective tax rate to be in the range of 32-33% of pre-tax income.

Average Balances, Interest Rates and Yields

The following table presents, for the periods indicated, the total dollar amount of interest income from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin. Average balances of loans receivable include the average balances of non-accrual loans for each period. Interest income on loans includes interest received on non-accrual loans on a cash basis. Interest income on loans includes the amortization of net loan fees, which were deferred in accordance with accounting standards. Fees included in interest income were $647,000 and $990,000 for the three months ended September 30, 2008 and 2007, respectively. Fees included in interest income were $2.0 million and $2.4 million for the nine months ended September 30, 2008 and 2007, respectively. Tax-exempt income was not calculated on a tax equivalent basis. The table does not reflect any effect of income taxes.

	September 30, 2008	Three Months Ended September 30, 2008			Three Months Ended September 30, 2007		
	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
				(Dollars in thousands)			
Interest-earning assets:							
Loans receivable:							
One- to four-family residential	6.28%	$ 213,136	$ 3,389	6.33%	$ 182,645	$ 3,239	7.04%
Other residential	6.73	118,265	1,862	6.26	80,371	1,722	8.50
Commercial real estate	6.49	494,780	8,056	6.48	449,170	9,340	8.25
Construction	6.11	622,000	9,483	6.07	696,754	14,624	8.33
Commercial business	5.78	148,015	2,255	6.06	177,655	3,783	8.45
Other loans	7.58	187,446	3,067	6.51	153,184	2,932	7.59
Industrial revenue bonds(1)	6.40	52,204	880	6.71	58,021	996	6.81
Total loans receivable	6.42	1,835,846	28,992	6.28	1,797,800	36,636	8.08
Investment securities and other interest-earning assets(1)	4.84	498,037	6,032	4.82	427,076	5,340	4.96
Total interest-earning assets	6.05	2,333,883	35,024	5.97	2,224,876	41,976	7.49
Non-interest-earning assets:							
Cash and cash equivalents		63,274			82,280		
Other non-earning assets		72,829			53,502		
Total assets		$ 2,469,986			$ 2,360,658		
Interest-bearing liabilities:							
Interest-bearing demand and savings	1.42	$ 436,129	1,646	1.50	$ 490,898	4,340	3.51
Time deposits	3.69	1,273,854	12,062	3.77	1,140,326	15,527	5.40
Total deposits	3.14	1,709,983	13,708	3.19	1,631,224	19,867	4.83
Short-term borrowings and structured repo	2.32	275,507	1,473	2.13	173,999	1,917	4.37
	4.37	30,929	336	4.32	30,335	522	6.83

Subordinated debentures issued to capital trust							
FHLB advances	3.63	122,969	1,140	3.69	141,552	1,738	4.87
Total interest-bearing liabilities	3.07	2,139,388	16,657	3.10	1,977,110	24,044	4.83
Non-interest-bearing liabilities:							
Demand deposits		146,983			167,290		
Other liabilities		9,881			30,381		
Total liabilities		2,296,252			2,174,781		
Stockholders' equity		173,734			185,877		
Total liabilities and stockholders' equity		$ 2,469,986			$ 2,360,658		
Net interest income:							
Interest rate spread	2.98%		$ 18,367	2.87%		$ 17,932	2.66%
Net interest margin*				3.13%			3.20%
Average interest-earning assets to average interest-bearing liabilities		109.1%			112.5%		

* Defined as the Company's net interest income divided by total interest-earning assets.

(1) Of the total average balances of investment securities, average tax-exempt investment securities were $59.1 million and $70.4 million for the three months ended September 30, 2008 and 2007, respectively. In addition, average tax-exempt loans and industrial revenue bonds were $29.9 million and $30.5 million for the three months ended September 30, 2008 and 2007, respectively. Interest income on tax-exempt assets included in this table was $1.4 million and $953,000 for the three months ended September 30, 2008 and 2007, respectively. Interest income net of disallowed interest expense related to tax-exempt assets was $1.2 million and $629,000 for the three months ended September 30, 2008 and 2007, respectively.

	September 30, 2008	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007		
	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
		(Dollars in thousands)					
Interest-earning assets:							
Loans receivable:							
One- to four-family residential	6.28%	$ 203,310	$ 9,937	6.53%	$ 177,431	$ 9,356	7.05%
Other residential	6.73	105,115	5,338	6.78	80,874	5,195	8.59
Commercial real estate	6.49	479,364	24,243	6.76	452,512	28,449	8.41
Construction	6.11	669,609	32,342	6.45	673,304	42,562	8.45
Commercial business	5.78	172,097	7,966	6.18	167,900	10,588	8.43
Other loans	7.58	175,519	8,822	6.71	148,732	8,445	7.59
Industrial revenue bonds(1)	6.40	53,780	2,745	6.82	56,502	2,882	6.82
Total loans receivable	6.42	1,858,794	91,393	6.57	1,757,255	107,477	8.18
Investment securities and other interest-earning assets(1)	4.84	491,339	17,635	4.79	430,378	15,661	4.87
Total interest-earning assets	6.05	2,350,133	109,028	6.20	2,187,633	123,138	7.53
Non-interest-earning assets:							
Cash and cash equivalents		68,706			88,270		
Other non-earning assets		72,449			47,974		
Total assets		$ 2,491,288			$ 2,323,877		
Interest-bearing liabilities:							
Interest-bearing demand and savings	1.42	$ 516,734	7,119	1.84	$ 470,413	12,076	3.43
Time deposits	3.69	1,219,780	38,352	4.20	1,137,975	45,413	5.34
Total deposits	3.14	1,736,514	45,471	3.50	1,608,388	57,489	4.78
Short-term borrowings and structured repo	2.32	244,435	4,255	2.33	167,630	5,576	4.45
Subordinated debentures issued to capital trust	4.37	30,929	1,097	4.74	27,311	1,402	6.86
FHLB advances	3.63	137,245	3,864	3.76	137,274	5,065	4.93

Total interest-bearing liabilities	3.07	2,149,123	54,687	3.40	1,940,603	69,532	4.79
Non-interest-bearing liabilities:							
Demand deposits		149,446			171,230		
Other liabilities		10,671			28,146		
Total liabilities		2,309,240			2,139,979		
Stockholders' equity		182,048			183,898		
Total liabilities and stockholders' equity		$ 2,491,288			$ 2,323,877		
Net interest income:							
Interest rate spread	2.98%		$ 54,341	2.80%		$ 53,606	2.74%
Net interest margin*				3.09%			3.28%
Average interest-earning assets to average interest-bearing liabilities		109.4%			112.7%		

* Defined as the Company's net interest income divided by total interest-earning assets.

(1) Of the total average balances of investment securities, average tax-exempt investment securities were $65.3 million and $68.6 million for the nine months ended September 30, 2008 and 2007, respectively. In addition, average tax-exempt loans and industrial revenue bonds were $30.7 million and $29.8 million for the nine months ended September 30, 2008 and 2007, respectively. Interest income on tax-exempt assets included in this table was $3.8 million and $3.3 million for the nine months ended September 30, 2008 and 2007, respectively. Interest income net of disallowed interest expense related to tax-exempt assets was $3.4 million and $2.3 million for the nine months ended September 30, 2008 and 2007, respectively.

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities for the periods shown. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in rate (i.e., changes in rate multiplied by old volume) and (ii) changes in volume (i.e., changes in volume multiplied by old rate). For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to volume and rate. Tax-exempt income was not calculated on a tax equivalent basis.

	Three Months Ended September 30, 2008 vs. 2007		
	Increase (Decrease) Due to		Total Increase (Decrease)
	Rate	Volume	
	(Dollars in thousands)		
Interest-earning assets:			
Loans receivable	$ (8,386)	$ 742	$ (7,644)
Investment securities and other interest-earning assets	(157)	849	692
Total interest-earning assets	(8,543)	1,591	(6,952)
Interest-bearing liabilities:			
Demand deposits	(2,154)	(540)	(2,694)
Time deposits	(5,099)	1,634	(3,465)
Total deposits	(7,253)	1,094	(6,159)
Short-term borrowings and structured repo	(1,246)	802	(444)
Subordinated debentures issued to capital trust	(196)	10	(186)
FHLBank advances	(316)	(282)	(598)
Total interest-bearing liabilities	(9,011)	1,624	(7,387)
Net interest income	$ 468	$ (33)	$ 435

51

	Nine Months Ended September 30, 2008 vs. 2007		
	Increase (Decrease) Due to		Total Increase (Decrease)
	Rate	Volume	
	(Dollars in thousands)		
Interest-earning assets:			
Loans receivable	$ (22,062)	$ 5,978	$ (16,084)
Investment securities and other interest-earning assets	(231)	2,205	1,974
Total interest-earning assets	(22,293)	8,183	(14,110)
Interest-bearing liabilities:			
Demand deposits	(6,056)	1,099	(4,957)
Time deposits	(10,172)	3,111	(7,061)
Total deposits	(16,228)	4,210	(12,018)
Short-term borrowings and structured repo	(3,288)	1,967	(1,321)
Subordinated debentures issued to capital trust	(475)	170	(305)
FHLBank advances	(1,200)	(1)	(1,201)
Total interest-bearing liabilities	(21,191)	6,346	(14,845)
Net interest income	$ (1,102)	$ 1,837	$ 735

Liquidity and Capital Resources

Liquidity is a measure of the Company's ability to generate sufficient cash to meet present and future financial obligations in a timely manner through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. These obligations include the credit needs of customers, funding deposit withdrawals, and the day-to-day operations of the Company. Liquid assets include cash, interest-bearing deposits with financial institutions and certain investment securities and loans. As a result of the Company's management of the ability to generate liquidity primarily through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and meet its customers' credit needs. At September 30, 2008, the Company had commitments of approximately $5.8 million to fund loan originations, $174.1 million of unused lines of credit and unadvanced loans, and $18.1 million of outstanding letters of credit.

Management continuously reviews the capital position of the Company and the Bank to ensure compliance with minimum regulatory requirements, as well as exploring ways to increase capital either by retained earnings or other means.

The Company's stockholders' equity was $168.8 million, or 6.7% of total assets of $2.53 billion at September 30, 2008, compared to equity of $189.9 million, or 7.8%, of total assets of $2.43 billion at December 31, 2007.

Banks are required to maintain minimum risk-based capital ratios. These ratios compare capital, as defined by the risk-based regulations, to assets adjusted for their relative risk as defined by the regulations. Guidelines require banks to have a minimum Tier 1 risk-based capital ratio, as defined, of 4.00%, a minimum total risk-based capital ratio of 8.00%, and a minimum 4.00% Tier 1 leverage ratio. To be considered "well capitalized," banks must have a minimum Tier 1 risk-based capital ratio, as defined, of 6.00%, a minimum total risk-based capital ratio of 10.00%, and a minimum 5.00% Tier 1 leverage ratio. On September 30, 2008, the Bank's Tier 1 risk-based capital ratio was 10.26%, total risk-based capital ratio was 11.52% and the Tier 1 leverage ratio was 8.10%. As of September 30, 2008, the Bank was "well capitalized" as defined by the Federal banking agencies' capital-related regulations. The Federal Reserve Bank has established capital regulations for bank holding companies that generally parallel the capital regulations for banks. On September 30, 2008, the Company's Tier 1 risk-based capital ratio was 10.36%, total risk-based capital ratio was 11.61% and the leverage ratio was 8.18%. As of September 30, 2008, the Company was "well capitalized" as defined by the Federal banking agencies' capital-related regulations.

The Company's primary sources of funds are certificates of deposit, FHLBank advances, other borrowings, loan repayments, unpledged securities, proceeds from sales of loans and available-for-sale securities and funds provided from operations. The Company utilizes particular sources of funds based on the comparative costs and availability at the time. The Company has from time to time chosen not to pay rates on deposits as high as the rates paid by certain of its competitors and, when believed to be appropriate, supplements deposits with less expensive alternative sources of funds. At November 7, 2008, the Company had these available secured lines and on-balance sheet liquidity:

Federal Home Loan Bank line	$216.6 million
Federal Reserve Bank line	$217.1 million
Interest Bearing Deposits	$87.8 million
Unpledged Securities	$194.6 million

Statements of Cash Flows. During the nine months ended September 30, 2008 and 2007, respectively, the Company had positive cash flows from operating activities and positive cash flows from financing activities. The Company experienced negative cash flows from investing activities during each of these same time periods.

Cash flows from operating activities for the periods covered by the Statements of Cash Flows have been primarily related to changes in accrued and deferred assets, credits and other liabilities, the provision for loan losses, depreciation, and the amortization of deferred loan origination fees and discounts (premiums) on loans and investments, all of which are non-cash or non-operating adjustments to operating cash flows. Net income adjusted for non-cash and non-operating items and the origination and sale of loans held for sale were the primary source of cash flows from operating activities. Operating activities provided cash flows of $37.3 million

53

during the nine months ended September 30, 2008, and $18.8 million during the nine months ended September 30, 2007.

During the nine months ended September 30, 2008 and 2007, investing activities used cash of $110.5 million and $173.1 million, respectively, primarily due to the net increase of loans and investment securities in each period.

Changes in cash flows from financing activities during the periods covered by the Statements of Cash Flows are due to changes in deposits after interest credited, changes in FHLBank advances and changes in short-term borrowings, as well as stock repurchases and dividend payments to stockholders. Financing activities provided $115.7 million during the nine months ended September 30, 2008 and $142.1 million during the nine months ended September 30, 2007. Financing activities in the future are expected to primarily include changes in deposits, changes in FHLBank advances, changes in short-term borrowings, stock repurchases and dividend payments to stockholders.

Dividends. During the three months ended September 30, 2008, the Company declared a dividend of $0.18 per share (which was paid in October 2008), or over 100% of net income per diluted share for that three month period, and paid a dividend of $0.18 per share (which was declared in June 2008). During the three months ended September 30, 2007, the Company declared a dividend of $0.17 per share (which was paid in October 2007), or 31% of net income per diluted share for that three month period, and paid a dividend of $0.17 per share (which was declared in June 2007).

During the nine months ended September 30, 2008, the Company declared dividends of $0.54 per share and paid dividends of $0.54 per share, or over 100% of net income per diluted share for that nine month period. During the nine months ended September 30, 2007, the Company declared dividends of $0.50 per share, or 30% of net income per diluted share for that nine month period, and paid dividends of $0.49 per share.

Common Stock Repurchases and Issuances. The Company has been in various buy-back programs since May 1990. During the three months ended September 30, 2008, the Company did not repurchase any shares of its common stock and did not issue any shares of stock to cover stock option exercises. During the three months ended September 30, 2007, the Company repurchased 94,454 shares of its common stock at an average price of $25.39 per share and issued 19,386 shares of stock at an average price of $19.34 per share to cover stock option exercises.

During the nine months ended September 30, 2008, the Company repurchased 21,200 shares of its common stock at an average price of $19.19 per share and issued 1,972 shares of stock at an average price of $13.23 per share to cover stock option exercises. During the nine months ended September 30, 2007, the Company repurchased 223,948 shares of its common stock at an average price of $26.95 per share and issued 51,534 shares of stock at an average price of $18.97 per share to cover stock option exercises.

Management intends to continue its stock buy-back programs from time to time as long as it believes that repurchasing the stock contributes to the overall growth of shareholder value. The

number of shares of stock that will be repurchased and the price that will be paid is the result of many factors, several of which are outside the control of the Company. The primary factors, however, are the number of shares available in the market from sellers at any given time, the price of the stock within the market as determined by the market, and the projected impact on the Company's capital and earnings per share.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Asset and Liability Management and Market Risk

A principal operating objective of the Company is to produce stable earnings by achieving a favorable interest rate spread that can be sustained during fluctuations in prevailing interest rates. The Company has sought to reduce its exposure to adverse changes in interest rates by attempting to achieve a closer match between the periods in which its interest-bearing liabilities and interest-earning assets can be expected to reprice through the origination of adjustable-rate mortgages and loans with shorter terms to maturity and the purchase of other shorter term interest-earning assets. Since the Company uses laddered brokered deposits and FHLBank advances to fund a portion of its loan growth, the Company's assets tend to reprice more quickly than its liabilities.

Our Risk When Interest Rates Change

The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

How We Measure the Risk To Us Associated with Interest Rate Changes

In an attempt to manage our exposure to changes in interest rates and comply with applicable regulations, we monitor Great Southern's interest rate risk. In monitoring interest rate risk we regularly analyze and manage assets and liabilities based on their payment streams and interest rates, the timing of their maturities and their sensitivity to actual or potential changes in market interest rates.

The ability to maximize net interest income is largely dependent upon the achievement of a positive interest rate spread that can be sustained despite fluctuations in prevailing interest rates. Interest rate sensitivity is a measure of the difference between amounts of interest-earning assets and interest-bearing liabilities which either reprice or mature within a given period of time. The difference, or the interest rate repricing "gap," provides an indication of the extent to which an institution's interest rate spread will be affected by changes in interest rates. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities repricing during the same period, and is considered negative when the amount of interest-rate sensitive liabilities exceeds the amount of interest-rate sensitive assets during the same period. Generally, during a period of falling interest rates, a positive gap within shorter repricing periods would adversely affect net interest income, while a negative gap within shorter

repricing periods would result in an increase in net interest income. During a period of rising interest rates, the opposite would be true. As of September 30, 2008, Great Southern's internal interest rate risk models indicate a one-year interest rate sensitivity gap that is negative. Generally, a rate decrease by the FRB (which appears to be the current consensus environment for the FRB) would be expected to have an immediate adverse impact on Great Southern's net interest income due to the large total balances of loans which adjust to the "prime interest rate" daily. As the Federal Funds rate is now very low, the adverse impact is currently largely mitigated by the Company's interest rate floors on most of these daily-adjust loans. In addition, Great Southern has elected to leave its "Prime Rate" at 5.00% for those loans that are indexed to "Great Southern Prime" rather than "Wall Street Journal Prime." The Company believes that this slight adverse impact could be negated over the subsequent 60- to 120-day period as the Company's interest rates on deposits, borrowings and interest rate swaps should also decrease proportionately to the changes by the FRB, assuming normal credit, liquidity and competitive pricing pressures. However, the operating environment has not been normal and interest cost for deposits and borrowings have been and continue to be elevated because of abnormal credit, liquidity and competitive pricing pressures, therefore we expect the net interest margin will continue to be somewhat compressed.

Interest rate risk exposure estimates (the sensitivity gap) are not exact measures of an institution's actual interest rate risk. They are only indicators of interest rate risk exposure produced in a simplified modeling environment designed to allow management to gauge the Bank's sensitivity to changes in interest rates. They do not necessarily indicate the impact of general interest rate movements on the Bank's net interest income because the repricing of certain categories of assets and liabilities is subject to competitive and other factors beyond the Bank's control. As a result, certain assets and liabilities indicated as maturing or otherwise repricing within a stated period may in fact mature or reprice at different times and in different amounts and cause a change, which potentially could be material, in the Bank's interest rate risk.

In order to minimize the potential for adverse effects of material and prolonged increases and decreases in interest rates on Great Southern's results of operations, Great Southern has adopted asset and liability management policies to better match the maturities and repricing terms of Great Southern's interest-earning assets and interest-bearing liabilities. Management recommends and the Board of Directors sets the asset and liability policies of Great Southern which are implemented by the asset and liability committee. The asset and liability committee is chaired by the Chief Financial Officer and is comprised of members of Great Southern's senior management. The purpose of the asset and liability committee is to communicate, coordinate and control asset/liability management consistent with Great Southern's business plan and board-approved policies. The asset and liability committee establishes and monitors the volume and mix of assets and funding sources taking into account relative costs and spreads, interest rate sensitivity and liquidity needs. The objectives are to manage assets and funding sources to produce results that are consistent with liquidity, capital adequacy, growth, risk and profitability goals. The asset and liability committee meets on a monthly basis to review, among other things, economic conditions and interest rate outlook, current and projected liquidity needs and capital positions and anticipated changes in the volume and mix of assets and liabilities. At each meeting, the asset and liability committee recommends appropriate strategy changes based on this review. The Chief Financial Officer or his designee is responsible for reviewing and reporting on the effects of the policy implementations and strategies to the Board of Directors at their monthly meetings.

In order to manage its assets and liabilities and achieve the desired liquidity, credit quality, interest rate risk, profitability and capital targets, Great Southern has focused its strategies on originating adjustable rate loans, and managing its deposits and borrowings to establish stable relationships with both retail customers and wholesale funding sources.

At times, depending on the level of general interest rates, the relationship between long- and short-term interest rates, market conditions and competitive factors, we may determine to increase our interest rate risk position somewhat in order to maintain or increase our net interest margin.

The asset and liability committee regularly reviews interest rate risk by forecasting the impact of alternative interest rate environments on net interest income and market value of portfolio equity, which is defined as the net present value of an institution's existing assets, liabilities and off-balance sheet instruments, and evaluating such impacts against the maximum potential changes in net interest income and market value of portfolio equity that are authorized by the Board of Directors of Great Southern.

The Company enters into interest-rate swap derivatives, primarily as an asset/liability management strategy in order to hedge the change in the fair value from recorded fixed rate liabilities (long term fixed rate CDs). The terms of the swaps are carefully matched to the terms of the underlying hedged item and when the relationship is properly documented as a hedge and proven to be effective, it is designated as a fair value hedge. The fair market value of derivative financial instruments is based on the present value of future expected cash flows from those instruments discounted at market forward rates and are recognized in the statement of financial condition in the prepaid expenses and other assets or accounts payable and accrued expenses caption. Effective changes in the fair market value of the hedged item due to changes in the benchmark interest rate are similarly recognized in the statement of financial condition in the prepaid expenses and other assets or accounts payable and accrued expenses caption. Effective gains/losses are reported in interest expense and $244,000 and $1.0 million of ineffectiveness was recorded in income in the non-interest income caption for the three and nine months ended September 30, 2008, respectively. Gains and losses on early termination of the designated fair value derivative financial instruments are deferred and amortized as an adjustment to the yield on the related liability over the shorter of the remaining contract life or the maturity of the related asset or liability. If the related liability is sold or otherwise liquidated, the fair market value of the derivative financial instrument is recorded on the balance sheet as an asset or a liability (in prepaid expenses and other assets or accounts payable and accrued expenses) with the resultant gains and losses recognized in non-interest income.

At September 30, 2008, the Company had six SFAS No. 133 designated swaps with Lehman Brothers Special Financing, Inc. (“Lehman”). On September 15, 2008, Lehman filed for bankruptcy protection and hedge accounting was immediately terminated. The fair market value of the underlying hedged items (certificates of deposit) through September 15, 2008, is being amortized over the remaining life of the hedge period on a straight-line basis. The fair market value of the swaps as of September 15, 2008, included both assets and liabilities totaling a net asset of $235,000. These swaps were valued using the income approach with observable Level 2 market expectations at the measurement date and standard valuation techniques to convert future amounts to a single discounted present amount. The Level 2 inputs are limited to quoted prices

for similar assets or liabilities in active markets (specifically futures contracts on LIBOR for the first two years) and inputs other than quoted prices that are observable for the asset or liability (specifically LIBOR cash and swap rates, volatilities and credit risk at commonly quoted intervals). Mid-market pricing is used as a practical expedient for fair value measurements. The Company has a netting agreement with Lehman and the collectability of the net asset is uncertain at this time. The Company has a valuation allowance of $235,000 on the asset as of September 30, 2008.

The Company has entered into interest rate swap agreements with the objective of economically hedging against the effects of changes in the fair value of its liabilities for fixed rate brokered certificates of deposit caused by changes in market interest rates. The swap agreements generally provide for the Company to pay a variable rate of interest based on a spread to the one-month or three-month London Interbank Offering Rate (LIBOR) and to receive a fixed rate of interest equal to that of the hedged instrument. Under the swap agreements the Company is to pay or receive interest monthly, quarterly, semiannually or at maturity.

In addition to the disclosures previously made by the Company in the December 31, 2007, Annual Report on Form 10-K, the following table summarizes interest rate sensitivity information for the Company's interest rate derivatives at September 30, 2008.

Interest Rate Derivatives		Fixed to Variable (In Millions)	Average Pay Rate	Average Receive Rate
Interest Rate Swaps:				
Expected Maturity Date				
2008	$	4.8	2.94%	3.75%
2011		4.6	2.72	4.00
2017		7.0	2.73	5.00
2019		21.2	2.76	5.30
Total Notional Amount	$	37.6	2.77%	4.89%
Fair Value Adjustment				
Asset (Liability)	$	(0.4)		

ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of disclosure controls and procedures (as defined in Rule 13(a)-15(e) under the Securities Exchange Act (the "Exchange Act")) that is designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported accurately and within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate. An evaluation of our disclosure controls and procedures was carried out as of September 30, 2008, under the supervision and with the participation of our principal executive officer, principal financial officer and several other members of our senior management. Our principal executive officer and principal financial officer concluded that, as of

September 30, 2008, our disclosure controls and procedures were effective in ensuring that the information we are required to disclose in the reports we file or submit under the Act is (i) accumulated and communicated to our management (including the principal executive officer and principal financial officer) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Act) that occurred during the quarter ended September 30, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We do not expect that our internal control over financial reporting will prevent all errors and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the normal course of business, the Company and its subsidiaries are subject to pending and threatened legal actions, some for which the relief or damages sought are substantial. After reviewing pending and threatened litigation with counsel, management believes at this time that the outcome of such litigation will not have a material adverse effect on the results of operations or stockholders' equity. No assurance can be given in this regard, however.

Item 1A. Risk Factors

Set forth below are updates and additions to the market risk information provided in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2007. These updates and additions should be read in conjunction with the 2007 Form 10-K information.

Difficult market conditions and economic trends have adversely affected our industry and our business.

Negative developments beginning in the latter half of 2007 in the sub-prime mortgage market and the securitization markets for such loans, together with substantially increased oil prices and other factors, have resulted in uncertainty in the financial markets in general and a related general economic downturn, which have continued in 2008. Dramatic declines in the housing market, with decreasing home prices and increasing delinquencies and foreclosures, have negatively impacted the credit performance of mortgage and construction loans and resulted in significant write-downs of assets by many financial institutions. In addition, the values of real estate collateral supporting many loans have declined and may continue to decline. General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. Competition among depository institutions for deposits has increased significantly. Financial institutions have experienced decreased access to deposits or borrowings.

The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations and stock price.

Our ability to assess the creditworthiness of customers and to estimate the losses inherent in our credit exposure is made more complex by these difficult market and economic conditions. As a result of the foregoing factors, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations. This increased government action may increase our costs and limit our ability to pursue certain

business opportunities. We also may be required to pay even higher Federal Deposit Insurance Corporation premiums than the recently increased level, because financial institution failures resulting from the depressed market conditions have depleted and may continue to deplete the deposit insurance fund and reduce its ratio of reserves to insured deposits.

We do not believe these difficult conditions are likely to improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market and economic conditions on us, our customers and the other financial institutions in our market. As a result, we may experience increases in foreclosures, delinquencies and customer bankruptcies, as well as more restricted access to funds.

We may elect or be compelled to seek additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. In addition, we may elect to raise additional capital to support the growth of our business or to finance acquisitions, if any, or we may elect to raise additional capital for other reasons. In that regard, a number of financial institutions have recently raised considerable amounts of capital as a result of deterioration in their results of operations and financial condition arising from the turmoil in the mortgage loan market, deteriorating economic conditions, declines in real estate values and other factors. Should we be required by regulatory authorities or otherwise elect to raise additional capital, we may seek to do so through the issuance of, among other things, our common stock or securities convertible into our common stock, which could dilute your ownership interest in the Company.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed or on terms acceptable to us. If we cannot raise additional capital when needed or on terms acceptable to us, it may have a material adverse effect on our financial condition and results of operations.

Recent legislative and regulatory initiatives to address these difficult market and economic conditions may not stabilize the U.S. banking system.

The recently enacted Emergency Economic Stabilization Act of 2008 (“EESA”) authorizes the United States Department of the Treasury, hereafter the Treasury Department, to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a troubled asset relief program. The purpose of the troubled asset relief program is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury Department has allocated $250 billion towards the troubled asset relief program capital purchase program. Under the capital purchase program, the Treasury Department will purchase debt or equity securities from participating institutions. The troubled asset relief program is also expected to include direct purchases or guarantees of

troubled assets of financial institutions.

EESA also increased Federal Deposit Insurance Corporation deposit insurance on most accounts from $100,000 to $250,000. This increase is in place until the end of 2009 and is not covered by deposit insurance premiums paid by the banking industry. In addition, the Federal Deposit Insurance Corporation has implemented two temporary programs to provide deposit insurance for the full amount of most non-interest bearing transaction accounts through the end of 2009 and to guarantee certain unsecured debt of financial institutions and their holding companies through June 2012. Financial institutions have until December 5, 2008 to opt out of these two programs. The purpose of these legislative and regulatory actions is to stabilize the volatility in the U.S. banking system.

EESA, the troubled asset relief program and the Federal Deposit Insurance Corporation's recent regulatory initiatives may not stabilize the U.S. banking system or financial markets. If the volatility in the market and the economy continue or worsen, our business, financial condition, results of operations, access to funds and the price of our stock could be materially and adversely impacted.

Other than as set forth above, there have been no material changes to the risk factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On November 15, 2006, the Company's Board of Directors authorized management to repurchase up to 700,000 shares of the Company's outstanding common stock, under a program of open market purchases or privately negotiated transactions. The plan does not have an expiration date. Information on the shares purchased during the third quarter of 2008 is shown below.

	Total Number of Shares Purchased	Average Price Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Purchased Under the Plan(1)
July 1, 2008 – July 31, 2008	---	$----	---	396,562
August 1, 2008 - August 31, 2008	---	$----	---	396,562
September 1, 2008 - September 30, 2008	---	$----	---	396,562
	---	$----	---	

(1) Amount represents the number of shares available to be repurchased under the plan as of the last calendar day of the month shown.

Item 3. Defaults Upon Senior Securities

None.

62

Item 4. Submission of Matters to Vote of Common Stockholders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Financial Statement Schedules

a) Exhibits

See Exhibit Index.

63

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Great Southern Bancorp, Inc. Registrant
Date: November 10, 2008	/s/ Joseph W. Turner Joseph W. Turner President and Chief Executive Officer (Principal Executive Officer)
Date: November 10, 2008	/s/ Rex A. Copeland Rex A. Copeland Treasurer (Principal Financial and Accounting Officer)

64

EXHIBIT INDEX

Exhibit No. Description

(2) Plan of acquisition, reorganization, arrangement, liquidation, or succession

Inapplicable.

(3) Articles of incorporation and Bylaws

(i) The Registrant's Charter previously filed with the Commission as Appendix D to the Registrant's Definitive Proxy Statement on Schedule 14A filed on March 31, 2004 (File No. 000-18082), is incorporated herein by reference as Exhibit 3.1.

(ii) The Registrant's Bylaws, previously filed with the Commission (File no. 000-18082) as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on October 19, 2007, is incorporated herein by reference as Exhibit 3.2.

(4) Instruments defining the rights of security holders, including indentures

The Company hereby agrees to furnish the SEC upon request, copies of the instruments defining the rights of the holders of each issue of the Registrant's long-term debt.

(9) Voting trust agreement

Inapplicable.

(10) Material contracts

The Registrant's 1989 Stock Option and Incentive Plan previously filed with the Commission (File no. 000-18082) as Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended June 30, 1990, is incorporated herein by reference as Exhibit 10.1.

The Registrant's 1997 Stock Option and Incentive Plan previously filed with the Commission (File no. 000-18082) as Annex A to the Registrant's Definitive Proxy Statement on Schedule 14A filed on September 18, 1997 is incorporated herein by reference as Exhibit 10.2.

The Registrant's 2003 Stock Option and Incentive Plan previously filed with the Commission (File No. 000-18082) as Annex A to the Registrant's Definitive Proxy Statement on Schedule 14A filed on April 14, 2003, is incorporated herein by reference as Exhibit 10.3.

The employment agreement dated September 18, 2002 between the Registrant and William V. Turner previously filed with the Commission (File no. 000-18082) as Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, is incorporated herein by reference as Exhibit 10.4.

The employment agreement dated September 18, 2002 between the Registrant and Joseph W. Turner previously filed with the Commission (File no. 000-18082) as Exhibit 10.4 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, is incorporated herein by reference as Exhibit 10.5.

The form of incentive stock option agreement under the Registrant's 2003 Stock Option and Incentive Plan previously filed with the Commission as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File no. 000-18082) filed on February 24, 2005 is incorporated herein by reference as Exhibit 10.6.

The form of non-qualified stock option agreement under the Registrant's 2003 Stock Option and Incentive Plan previously filed with the Commission as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File no. 000-18082) filed on February 24, 2005 is incorporated herein by reference as Exhibit 10.7.

A description of the salary and bonus arrangements for 2008 for the Registrant's named executive officers previously filed with the Commission as Exhibit 10.8 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 is incorporated herein by reference as Exhibit 10.8.

A description of the current fee arrangements for the Registrant's directors previously filed with the Commission as Exhibit 10.9 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 is incorporated herein by reference as Exhibit 10.9.

(11) Statement re computation of per share earnings

Attached as Exhibit 11.

(15) Letter re unaudited interim financial information

Inapplicable.

(18) Letter re change in accounting principles

Inapplicable.

(19) Report furnished to securityholders.

Inapplicable.

(22) Published report regarding matters submitted to vote of security holders

Inapplicable.

(23) Consents of experts and counsel

Inapplicable.

(24) Power of attorney

None.

(31.1) Rule 13a-14(a) Certification of Chief Executive Officer

Attached as Exhibit 31.1

(31.2) Rule 13a-14(a) Certification of Treasurer

Attached as Exhibit 31.2

(32) Certification pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)

Attached as Exhibit 32.

(99) Additional Exhibits

None.