

FIRST FINANCIAL BANKSHARES INC

Form 10-Q

May 04, 2010

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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 March 31, 2010
Commission file number 0-7674
FIRST FINANCIAL BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

Texas

75-0944023

**(State or other jurisdiction of incorporation
or organization)**

**(I.R.S. Employer
Identification No.)**

400 Pine Street, Abilene, Texas

79601

(Address of principal executive offices)

(Zip Code)

(325) 627-7155

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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.

Large accelerated filer Accelerated filer Non-accelerated filer 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 Act). Yes No

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

Class	Outstanding at May 4, 2010
Common Stock, \$0.01 par value per share	20,847,889

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**PART I
FINANCIAL INFORMATION**

Item 1. Financial Statements.

The consolidated balance sheets of First Financial Bankshares, Inc. (the Company) at March 31, 2010 and 2009 and December 31, 2009, and the consolidated statements of earnings, comprehensive earnings, changes in shareholders equity and cash flows for the three months ended March 31, 2010 and 2009, follow on pages 4 through 8.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	March 31, 2010	March 31, 2009	December 31, 2009
	(Unaudited)		
ASSETS			
CASH AND DUE FROM BANKS	\$ 95,234	\$ 112,207	\$ 139,915
FEDERAL FUNDS SOLD		46,575	14,290
INTEREST-BEARING DEPOSITS IN BANKS	192,848	2,636	167,336
Total cash and cash equivalents	288,082	161,418	321,541
TRADING SECURITIES, at fair value		93,195	
SECURITIES HELD-TO-MATURITY (fair value of \$11,831, \$20,626 and \$15,674 at March 31, 2010 and 2009 and December 31, 2009, respectively)	11,478	20,086	15,273
SECURITIES AVAILABLE-FOR-SALE, at fair value	1,396,230	1,217,185	1,270,104
LOANS			
Held for investment	1,496,444	1,465,310	1,510,046
Held for sale	2,557	14,242	4,323
	1,499,001	1,479,552	1,514,369
Less: Allowance for loan losses	(28,750)	(22,652)	(27,612)
Net loans	1,470,251	1,456,900	1,486,757
BANK PREMISES AND EQUIPMENT, net	65,652	64,888	64,363
INTANGIBLE ASSETS	62,993	63,781	63,152
OTHER ASSETS	58,269	43,909	58,266
Total assets	\$ 3,352,955	\$ 3,121,362	\$ 3,279,456
LIABILITIES AND SHAREHOLDERS EQUITY			
NONINTEREST-BEARING DEPOSITS	\$ 804,556	\$ 769,393	\$ 836,323
INTEREST-BEARING DEPOSITS	1,885,558	1,752,322	1,848,434
Total deposits	2,690,114	2,521,715	2,684,757
DIVIDENDS PAYABLE	7,087	7,074	7,081

SHORT-TERM BORROWINGS	189,095	166,347	146,094
OTHER LIABILITIES	42,838	44,687	25,822
Total liabilities	2,929,134	2,739,823	2,863,754

COMMITMENTS AND CONTINGENCIES**SHAREHOLDERS EQUITY**

Common stock \$0.01 par value, authorized 40,000,000 shares; 20,845,424, 20,804,668, and 20,826,431 shares issued at March 31, 2010 and 2009 and December 31, 2009, respectively	208	208	208
Capital surplus	269,880	268,271	269,294
Retained earnings	121,754	96,267	115,123
Treasury stock (shares at cost: 164,162, 159,236, and 162,836 at March 31, 2010 and 2009, and December 31, 2009, respectively)	(3,946)	(3,580)	(3,833)
Deferred compensation	3,946	3,580	3,833
Accumulated other comprehensive earnings	31,979	16,793	31,077
Total shareholders equity	423,821	381,539	415,702
Total liabilities and shareholders equity	\$ 3,352,955	\$ 3,121,362	\$ 3,279,456

See notes to consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)
(Dollars in thousands, except per share amounts)

	Three Months Ended March	
	2010	31, 2009
INTEREST INCOME:		
Interest and fees on loans	\$ 22,374	\$ 23,054
Interest on investment securities:		
Taxable	8,966	9,655
Exempt from federal income tax	4,633	4,128
Interest on trading securities		83
Interest on federal funds sold and interest-bearing deposits in banks	372	42
 Total interest income	 36,345	 36,962
INTEREST EXPENSE:		
Interest on deposits	3,535	4,777
Other	164	261
 Total interest expense	 3,699	 5,038
 Net interest income	 32,646	 31,924
PROVISION FOR LOAN LOSSES	2,010	1,761
 Net interest income after provision for loan losses	 30,636	 30,163
 NONINTEREST INCOME:		
Trust fees	2,526	2,117
Service charges on deposit accounts	4,858	5,141
ATM and credit card fees	2,511	2,209
Real estate mortgage operations	560	588
Net gain on securities transactions	1	249
Net gain on sale of student loans		616
Net gain (loss) on sale of foreclosed assets	11	(159)
Other	643	775
 Total noninterest income	 11,110	 11,536
NONINTEREST EXPENSE:		
Salaries and employee benefits	12,657	11,992
Net occupancy expense	1,578	1,620
Equipment expense	1,838	1,940
Printing, stationery and supplies	429	433
FDIC insurance premiums	988	951

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Correspondent bank service charges	191	312
ATM and interchange expense	774	801
Professional and service fees	693	746
Amortization of intangible assets	159	222
Other expenses	4,031	3,930
Total noninterest expense	23,338	22,947
EARNINGS BEFORE INCOME TAXES	18,408	18,752
INCOME TAX EXPENSE	4,691	5,048
NET EARNINGS	\$ 13,717	\$ 13,704
EARNINGS PER SHARE, BASIC	\$ 0.66	\$ 0.66
EARNINGS PER SHARE, ASSUMING DILUTION	\$ 0.66	\$ 0.66
DIVIDENDS PER SHARE	\$ 0.34	\$ 0.34

See notes to consolidated financial statements.

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

	Three Months Ended March	
	2010	2009
	31,	
	\$	\$
NET EARNINGS	13,717	13,704
OTHER ITEMS OF COMPREHENSIVE EARNINGS:		
Change in unrealized gain on investment securities available-for-sale, before income taxes	1,388	9,393
Reclassification adjustment for realized gains on investment securities included in net earnings, before income tax	(1)	(249)
Total other items of comprehensive earnings	1,387	9,144
Income tax expense	(485)	(3,201)
COMPREHENSIVE EARNINGS	\$ 14,619	\$ 19,647

See notes to consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in thousands, except per share amounts)

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Deferred Compensation	Accumulated Other Comprehensive Earnings	Total Shareholders' Equity
Balances at December 31, 2008	20,799,198	\$ 208	\$ 268,087	\$ 89,637	(158,811)	\$ (3,500)	\$ 3,500	\$ 10,850	\$ 368,782
Net earnings (unaudited)				13,704					13,704
Stock issuances (unaudited)	5,470		103						103
Cash dividends declared, \$0.34 per share (unaudited)				(7,074)					(7,074)
Change in unrealized gain (loss) in investment securities available-for-sale, net of related income taxes (unaudited)								5,943	5,943
Additional tax benefit related to directors' deferred compensation plan (unaudited)			15						15
Shares purchased in connection with directors' deferred compensation plan, net (unaudited)					(425)	(80)	80		
Stock option expense			66						66

(unaudited)

Balances at
March 31, 2009

(unaudited)	20,804,668	208	\$ 268,271	\$ 96,267	(159,236)	\$ (3,580)	\$ 3,580	\$ 16,793	\$ 381,539
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Balances at
December 31,
2009

	20,826,431	\$ 208	\$ 269,294	\$ 115,123	(162,836)	\$ (3,833)	\$ 3,833	\$ 31,077	\$ 415,702
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Net earnings
(unaudited)

				13,717					13,717
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Stock issuances
(unaudited)

	18,993		476						476
--	--------	--	-----	--	--	--	--	--	-----

Cash dividends
declared, \$0.34
per share
(unaudited)

				(7,086)					(7,086)
--	--	--	--	---------	--	--	--	--	---------

Change in
unrealized gain in
investment
securities
available- for-sale,
net of related
income taxes
(unaudited)

								902	902
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Additional tax
benefit related to
directors' deferred
compensation plan
(unaudited)

			15						15
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Shares purchased
in connection with
directors' deferred
compensation
plan, net
(unaudited)

				(1,326)	(113)	113			
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Stock option
expense
(unaudited)

			95						95
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	20,845,424	\$ 208	\$ 269,880	\$ 121,754	(164,162)	\$ (3,946)	\$ 3,946	\$ 31,979	\$ 423,821
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Balances at
March 31, 2010
(unaudited)

See notes to consolidated financial statements.

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

	Three Months Ended March	
	2010	31, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	\$ 13,717	\$ 13,704
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	1,777	1,956
Provision for loan losses	2,010	1,761
Securities premium amortization (discount accretion), net	914	256
Gain on sale of assets, net	(4)	(714)
Deferred federal income tax expense (benefit)		(2)
Trading security activity, net		(37,204)
Loans originated for resale	(20,985)	(65,914)
Proceeds from sales of loans held for resale	22,752	106,933
Change in other assets	958	8,580
Change in other liabilities	3,518	7,381
Total adjustments	10,940	23,033
Net cash provided by operating activities	24,657	36,737
CASH FLOWS FROM INVESTING ACTIVITIES:		
Activity in available-for-sale securities:		
Sales	3,219	5,309
Maturities	44,864	75,068
Purchases	(160,617)	(33,499)
Activity in held-to-maturity securities maturities	3,795	3,408
Net decrease in loans	11,633	43,410
Purchases of bank premises and equipment and computer software	(2,985)	(804)
Proceeds from sale of other assets	221	159
Net cash provided by (used in) investing activities	(99,870)	93,051
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in noninterest-bearing deposits	(31,767)	(27,684)
Net increase (decrease) in interest-bearing deposits	37,124	(33,354)
Net increase (decrease) in short-term borrowings	43,000	(69,251)
Common stock transactions:		
Proceeds from stock issuances	476	103
Dividends paid	(7,080)	(7,072)
Net cash provided by (used in) financing activities	41,753	(137,258)

NET DECREASE IN CASH AND CASH EQUIVALENTS	(33,460)	(7,470)
CASH AND CASH EQUIVALENTS, beginning of period	321,541	168,888
CASH AND CASH EQUIVALENTS, end of period	\$ 288,081	\$ 161,418

SUPPLEMENTAL INFORMATION AND NONCASH TRANSACTIONS

Interest paid	\$ 3,758	\$ 5,494
Federal income tax paid		
Transfer of loans to foreclosed assets	1,096	2,141
Investment securities purchased but not settled	13,126	16,787
See notes to consolidated financial statements.		

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

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

Through our subsidiary banks, we conduct a full-service commercial banking business. Our service centers are located primarily in North Central and West Texas. Considering the branches and locations of all our bank subsidiaries, as of March 31, 2010, we had 50 financial centers across Texas, with ten locations in Abilene, two locations in Cleburne, three locations in Stephenville, three locations in Granbury, two locations in San Angelo, three locations in Weatherford, and one location each in Mineral Wells, Hereford, Sweetwater, Eastland, Ranger, Rising Star, Southlake, Aledo, Willow Park, Brock, Alvarado, Burleson, Keller, Trophy Club, Boyd, Bridgeport, Decatur, Roby, Trent, Merkel, Clyde, Moran, Albany, Midlothian, Glen Rose, Odessa and Fort Worth. Our trust subsidiary has six locations in Abilene, San Angelo, Stephenville, Sweetwater, Fort Worth and Odessa, all in Texas.

In the opinion of management, the unaudited consolidated financial statements reflect all adjustments necessary for a fair presentation of the Company's financial position and unaudited results of operations and should be read in conjunction with the Company's consolidated financial statements, and notes thereto, for the year ended December 31, 2009. All adjustments were of a normal recurring nature. However, the results of operations for the three months ended March 31, 2010, are not necessarily indicative of the results to be expected for the year ending December 31, 2010, due to seasonality, changes in economic conditions and loan credit quality, interest rate fluctuations, regulatory and legislative changes and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) have been condensed or omitted under SEC rules and regulations. The Company evaluated subsequent events for potential recognition and/or disclosure through the date the consolidated financial statements were issued.

Goodwill and other intangible assets are evaluated annually for impairment as of the end of the second quarter. No such impairment has been noted in connection with these evaluations.

Note 2 Earnings Per Share

Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding during the periods presented. In computing diluted earnings per common share for the three months ended March 31, 2010 and 2009, the Company assumes that all dilutive outstanding options to purchase common stock have been exercised at the beginning of the period (or the time of issuance, if later). The dilutive effect of the outstanding options is reflected by application of the treasury stock method, whereby the proceeds from the exercised options are assumed to be used to purchase common stock at the average market price during the respective periods. The

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weighted average common shares outstanding used in computing basic earnings per common share for the three months ended March 31, 2010 and 2009, were 20,834,972 and 20,801,681 shares respectively. The weighted average common shares outstanding used in computing fully diluted earnings per common share for the three months ended March 31, 2010 and 2009, were 20,867,778 and 20,847,967, respectively.

Note 3 Securities

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

	March 31, 2010			
	Amortized	Gross	Gross	Estimated
	Cost Basis	Unrealized	Unrealized	Fair Value
		Holding	Holding	
		Gains	Losses	
Securities held-to-maturity:				
Obligations of state and political subdivisions	\$ 10,893	\$ 339	\$ (1)	\$ 11,231
Mortgage-backed securities	585	15		600
Total debt securities held-to-maturity	\$ 11,478	\$ 354	\$ (1)	\$ 11,831
Securities available-for-sale:				
U. S. Treasury Securities and obligations of U.S. government sponsored-enterprises and agencies	\$ 355,585	\$ 10,429	\$ (174)	\$ 365,840
Obligations of state and political subdivisions	450,045	20,592	(354)	470,283
Corporate bonds and other	59,883	4,871		64,754
Mortgage-backed securities	473,474	21,930	(51)	495,353
Total securities available-for-sale	\$ 1,338,987	\$ 57,822	\$ (579)	\$ 1,396,230
	December 31, 2009			
	Amortized	Gross	Gross	Estimated
	Cost Basis	Unrealized	Unrealized	Fair Value
		Holding	Holding	
		Gains	Losses	
Securities held-to-maturity:				
Obligations of state and political subdivisions	\$ 14,652	\$ 392	\$ (6)	\$ 15,038
Mortgage-backed securities	621	16	(1)	636
Total debt securities held-to-maturity	\$ 15,273	\$ 408	\$ (7)	\$ 15,674
Securities available-for-sale:				
Obligations of U.S. government sponsored-enterprises and agencies	\$ 260,018	\$ 12,050	\$	\$ 272,068
Obligations of state and political subdivisions	437,550	18,643	(561)	455,632
Corporate bonds and other	73,858	5,028		78,886
Mortgage-backed securities	442,823	20,995	(300)	463,518

Total securities available-for-sale	\$ 1,214,249	\$ 56,716	\$ (861)	\$ 1,270,104
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The Company invests in mortgage-backed securities that have expected maturities that differ from their contractual maturities. These differences arise because borrowers may have the right to call or prepay obligations with or without a prepayment penalty. These securities include collateralized mortgage obligations (CMOs) and other asset backed securities. The expected maturities of these securities at March 31, 2010, were computed by using scheduled amortization of balances and historical prepayment rates. At March 31, 2010 and 2009, the Company did not hold any CMOs that entail higher risks than standard mortgage-backed securities.

The amortized cost and estimated fair value of debt securities at March 31, 2010, by contractual and expected maturity, are shown below (in thousands):

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost Basis	Estimated Fair Value	Amortized Cost Basis	Estimated Fair Value
Due within one year	\$ 6,657	\$ 6,758	\$ 128,303	\$ 130,930
Due after one year through five years	4,076	4,314	450,682	468,696
Due after five years through ten years	70	70	254,703	268,866
Due after ten years	90	89	31,825	32,385
Mortgage-backed securities	585	600	473,474	495,353
Total	\$ 11,478	\$ 11,831	\$ 1,338,987	\$ 1,396,230

During the three months ended March 31, 2010 and 2009, sales of investment securities that were classified as available-for-sale totaled \$3.2 million and \$5.3 million, respectively. Gross realized gains from 2010 and 2009 securities sales totaled \$1 thousand and \$249 thousand, respectively. There were no losses realized on securities sales during these periods. The specific identification method was used to determine cost on computing the realized gains. The following tables disclose, as of March 31, 2010 and December 31, 2009, our available-for-sale and held-to-maturity securities that have been in a continuous unrealized-loss position for less than 12 months and those that have been in a continuous unrealized-loss position for 12 or more months (in thousands):

	Less than 12 Months Unrealized		12 Months or Longer Unrealized		Total Unrealized	
	Fair Value	Loss	Fair Value	Loss	Fair Value	Loss
March 31, 2010						
U. S. Treasury securities and obligations of U.S. government sponsored-enterprises and agencies	\$ 60,087	\$ 174	\$	\$	\$ 60,087	\$ 174
Obligations of state and political subdivisions	12,413	195	4,268	160	16,681	355
Mortgage-backed securities	26,965	50	39	1	27,004	51
Total	\$ 99,465	\$ 419	\$ 4,307	\$ 161	\$ 103,772	\$ 580
December 31, 2009						

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Obligations of state and political subdivisions	\$ 21,703	\$ 428	\$ 2,798	\$ 139	\$ 24,501	\$ 567
Mortgage-backed securities	27,619	300	82	1	27,701	301
Total	\$ 49,322	\$ 728	\$ 2,880	\$ 140	\$ 52,202	\$ 868

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The number of investment positions in this unrealized loss position totaled 66 at March 31, 2010. We do not believe these unrealized losses are other than temporary as (1) we do not have the intent to sell our securities prior to recovery and/or maturity and (2) it is more likely than not that we will not have to sell our securities prior to recovery and/or maturity. The unrealized losses noted are interest rate related due to the level of interest rates at March 31, 2010. We have reviewed the ratings of the issuers and have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities. Our mortgage related securities are backed by GNMA, FNMA and FHLMC or are collateralized by securities backed by these agencies.

As of March 31, 2009, trading securities totaled \$93.2 million. No amounts were held in trading securities at March 31, 2010. The trading securities portfolio is a government securities money market fund comprised primarily of U.S. government agency securities and repurchase agreements collateralized by U.S. government agency securities. The trading securities are carried at estimated fair value with unrealized gains and losses included in earnings. The Company invested in trading securities in 2008 to improve its yield on daily funds and to lower its exposure on Federal funds. However, due to significantly lower interest rates, the Company has deployed these funds into our investment portfolio and into certificates of deposit at unaffiliated banks.

Note 4 Loans And Allowance for Loan Losses

Major classifications of loans are as follows (dollars in thousands):

	March 31,		December
	2010	2009	31,
			2009
Commercial, financial and agricultural	\$ 457,377	\$ 460,318	\$ 508,431
Real estate construction	89,051	152,100	77,711
Real estate mortgage	782,725	673,625	752,735
Consumer	169,848	193,509	175,492
Total Loans	\$ 1,499,001	\$ 1,479,552	\$ 1,514,369

Included in real estate-mortgage above are \$2.6 million and \$4.3 million, respectively, in loans held for sale at March 31, 2010 and December 31, 2009 in which the carrying amounts approximate fair value. Included in real estate-mortgage and consumer loans above are \$4.5 million and \$9.9 million, respectively, in loans held for sale at March 31, 2009, in which the carrying amounts approximate fair value.

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

March 31, 2010		March 31, 2009		December 31, 2009	
Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
\$ 16,874	\$ 3,407	\$ 9,606	\$ 2,241	\$ 18,450	\$ 3,340

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The allowance for loan losses as of March 31, 2010 and 2009 and December 31, 2009, is presented below. The level of the allowance reflects our periodic evaluation of general economic conditions, the financial condition of our borrowers, the value and liquidity of collateral, delinquencies, prior loan loss experience, and the results of periodic reviews of the portfolio by our independent loan review department and regulatory examiners. Management has evaluated the adequacy of the allowance for loan losses by estimating the probable losses in various categories of the loan portfolio, which are identified below (in thousands):

	March 31,		December
	2010	2009	31, 2009
Allowance for loan losses provided for:			
Loans specifically evaluated as impaired	\$ 3,407	\$ 2,241	\$ 3,340
Remaining portfolio	25,343	20,411	24,272
Total allowance for loan losses	\$ 28,750	\$ 22,652	\$ 27,612

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

	Three Months Ended	
	March	March 31,
	31,	2009
	2010	
Balance at beginning of period	\$ 27,612	\$ 21,529
Add:		
Provision for loan losses	2,010	1,761
Loan recoveries	187	255
Deduct:		
Loan charge-offs	(1,059)	(893)
Balance at end of period	\$ 28,750	\$ 22,652

Nonaccrual, loans still accruing and past due 90 days or more, restructured loans and foreclosed assets are as follows (in thousands, except percentages):

	March 31,		December
	2010	2009	31, 2009
Nonaccrual loans	\$ 17,775	\$ 9,606	\$ 18,540
Loans still accruing and past due 90 days or more	290	94	15
Restructured loans			
Foreclosed assets	4,444	4,415	3,533
Total	\$ 22,509	\$ 14,115	\$ 22,088
As a % of total loans and foreclosed assets	1.50%	0.95%	1.46%

As a % of total assets	0.67%	0.45%	0.67%
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Note 5 Income Taxes

Income tax expense was \$4.7 million for the first quarter in 2010 as compared to \$5.0 million for the same period in 2009. Our effective tax rates on pretax income were 25.5% and 26.9% for the first quarters of 2010 and 2009, respectively. The effective tax rates differ from the statutory federal tax rate of 35% largely due to tax exempt interest income earned on certain investment securities and loans, the deductibility of dividends paid to our employee stock ownership plan and Texas state taxes.

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The decreases in the effective tax rates for the three-month period ended March 31, 2010 over the same period in 2009 were largely the result of an increase in tax exempt income.

Note 6 Stock Based Compensation

The Company grants incentive stock options for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of grant to employees. No stock options have been granted in 2010. In May 2009, the Company granted incentive stock options to purchase 101,600 shares of Company common stock with an exercise price of \$50.33 per share. The fair value of the options granted was estimated using the Black-Scholes options pricing model with the following weighted-average assumptions: risk-free interest rate of 3.24%; expected dividend yield of 2.66%; expected life of 5.79 years; and expected volatility of 41.64%.

The Company recorded stock option expense totaling approximately \$95 thousand and \$66 thousand, respectively, for the three-month periods ended March 31, 2010 and 2009.

The additional disclosure requirements under authoritative accounting guidance have been omitted due to immateriality.

Note 7 Pension Plan

The Company's defined benefit pension plan was frozen effective January 1, 2004, whereby no additional years of service will accrue to participants, unless the pension plan is reinstated at a future date. The pension plan covered substantially all of the Company's employees. The benefits for each employee were based on years of service and a percentage of the employee's qualifying compensation during the final years of employment. The Company's funding policy was and is to contribute annually the amount necessary to satisfy the Internal Revenue Service's funding standards. Contributions to the pension plan, prior to freezing the plan, were intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. As a result of the Pension Protection Act of 2006 (the Protection Act), the Company will be required to contribute amounts in future years to fund any shortfalls. The Company evaluated the provisions of the Protection Act as well as the Internal Revenue Service's funding standards to develop a preliminary plan for funding in future years. The Company made a contribution totaling \$1.0 million in March 2010 and \$1.4 million in April 2009 and continues to evaluate future funding amounts. Net periodic benefit costs totaling \$100 thousand and \$80 thousand were recorded, respectively, for the three months ended March 31, 2010 and 2009.

Table of Contents**Note 8 Recently Issued Authoritative Accounting Guidance**

In June 2009, the FASB issued authoritative guidance to improve the information a reporting entity provides in its financial statements about transfers of financial assets, including the effect of a transfer on an entity's financial position, financial performance and cash flows and the transferor's continuing involvement in the transferred assets. The guidance eliminates the concept of a qualifying special-purpose entity and changes the guidance for evaluation for consolidation. This guidance became effective January 1, 2010 and did not have a significant impact on the Company's financial position, results of operations or cash flows.

In 2010, the FASB issued authoritative guidance expanding disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. The new guidance further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) disclosures should be provided about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required beginning January 1, 2011. The remaining disclosure requirements and clarifications made by the new guidance became effective on January 1, 2010.

Note 9 Fair Value Disclosures

The authoritative accounting guidance for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The authoritative accounting guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the

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asset or liability developed based on the best information available in the circumstances. In that regard, the authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

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

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

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

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The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (dollars in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Available for sale investment securities:				
U. S. Treasury securities and obligations of U. S. government sponsored-enterprises and agencies	\$ 21,478	\$ 344,362	\$	\$ 365,840
Obligations of state and political subdivisions	13,767	456,516		470,283
Corporate bonds		59,151		59,151
Mortgage-backed securities	9,847	485,506		495,353
Other securities	5,603			5,603
	\$ 50,695	\$ 1,345,535	\$	\$ 1,396,230

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis include the following at March 31, 2010:

Impaired Loans Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 input based on the discounting of the collateral. At March 31, 2010, impaired loans with a carrying value of \$16.9 million were reduced by specific valuation allowances totaling \$3.4 million resulting in a net fair value of \$13.5 million, based on Level 3 inputs.

Loans Held for Sale Loans held for sale are reported at the lower of cost or fair value. In determining whether the fair value of loans held for sale is less than cost when quoted market prices are not available, the Company considers investor commitments/contracts. These loans are considered Level 2 of the fair value hierarchy. At March 31, 2010, the Company's mortgage loans held for sale were recorded at cost as fair value exceeded cost.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring and non-recurring basis include other real estate owned, goodwill and other intangible assets and other non-financial long-lived assets. Such amounts were not significant to the Company at March 31, 2010.

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

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

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

Financial instruments with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities. Financial instrument liabilities with no stated maturities have an estimated fair value equal to both the amount payable on demand and the carrying value. The carrying value and the estimated fair value of the Company's contractual off-balance-sheet unfunded lines of credit, loan commitments and letters of credit, which are generally priced at market at the time of funding, are not material.

The estimated fair values and carrying values of all financial instruments under current authoritative guidance at March 31, 2010, were as follows (in thousands):

	Carrying Value	Estimated Fair Value
Cash and due from banks	\$ 95,234	\$ 95,234
Interest-bearing deposits in banks	192,848	192,848
Held to maturity securities	11,478	11,831
Available for sale securities	1,396,230	1,396,230
Loans	1,499,001	1,499,548
Accrued interest receivable	18,127	18,127
Deposits with stated maturities	768,725	770,972
Deposits with no stated maturities	1,921,389	1,921,389
Short term borrowings	189,095	189,095
Accrued interest payable	1,178	1,178

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

Forward-Looking Statements

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

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

volatility and disruption in national and international financial markets;

legislative, tax and regulatory actions and reforms;

political instability;

the ability of the Federal government to deal with the national economic slowdown and the effect of stimulus packages enacted by Congress as well as future stimulus packages, if any;

competition from other financial institutions and financial holding companies;

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

changes in the demand for loans;

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

the accuracy of our estimates of future loan losses;