FIRST FINANCIAL BANKSHARES INC
Form 10-Q
July 27, 2012
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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 June 30, 2012

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	**(I.R.S. Employer**

incorporation or organization)	**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 x 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 x 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 x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 x

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

Class	**Outstanding at July 27, 2012**
Common Stock, $0.01 par value per share	31,482,177

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

The consolidated balance sheets of First Financial Bankshares, Inc. (the Company) at June 30, 2012 and 2011 and December 31, 2011, the consolidated statements of earnings and comprehensive earnings for the three and six months ended June 30, 2012 and 2011, and changes in shareholders equity and cash flows for the six months ended June 30, 2012 and 2011, 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)

	June 30, 2012	June 30, 2011	December 31, 2011
	(Unaudited)		
ASSETS			
CASH AND DUE FROM BANKS	$ 122,534	$ 106,500	$ 146,239
FEDERAL FUNDS SOLD	10,100	3,195	
INTEREST-BEARING DEPOSITS IN BANKS	25,794	114,776	104,597
Total cash and cash equivalents	158,428	224,471	250,836
INTEREST-BEARING TIME DEPOSITS IN BANKS	74,594	78,312	61,175
SECURITIES AVAILABLE-FOR-SALE, at fair value	1,961,908	1,639,992	1,841,389
SECURITIES HELD-TO-MATURITY (fair value of $1,485, $6,756 and $3,655 at June 30, 2012 and 2011 and December 31, 2011, respectively)	1,459	6,663	3,609
LOANS			
Held for investment	1,908,615	1,715,159	1,775,915
Less - allowance for loan losses	(34,747)	(33,406)	(34,315)
Net loans held for investment	1,873,868	1,681,753	1,741,600
Held for sale	9,677	4,256	10,629
Net loans	1,883,545	1,686,009	1,752,229
BANK PREMISES AND EQUIPMENT, net	80,404	72,550	76,483
INTANGIBLE ASSETS	72,040	72,307	72,122
OTHER ASSETS	59,426	60,711	62,688
Total assets	$ 4,291,804	$ 3,841,015	$ 4,120,531
LIABILITIES AND SHAREHOLDERS EQUITY			
NONINTEREST-BEARING DEPOSITS	$ 1,156,238	$ 989,271	$ 1,101,576
INTEREST-BEARING DEPOSITS	2,235,942	2,130,170	2,233,222
Total deposits	3,392,180	3,119,441	3,334,798
DIVIDENDS PAYABLE	7,870	7,548	7,550
SHORT-TERM BORROWINGS	251,428	192,364	207,756
OTHER LIABILITIES	106,063	43,957	61,890
Total liabilities	3,757,541	3,363,310	3,611,994
COMMITMENTS AND CONTINGENCIES			
SHAREHOLDERS EQUITY			
	315	314	314

Common stock - $0.01 par value, authorized 80,000,000 shares; 31,481,747, 31,451,300, and 31,459,635 shares issued at June 30, 2012 and 2011 and December 31, 2011, respectively			
Capital surplus	276,801	275,670	276,127
Retained earnings	205,554	164,417	184,871
Treasury stock (shares at cost: 263,917, 251,516, and 258,235 at June 30, 2012 and 2011 and December 31, 2011, respectively)	(4,763)	(4,394)	(4,597)
Deferred compensation	4,763	4,394	4,597
Accumulated other comprehensive earnings	51,593	37,304	47,225
Total shareholders equity	534,263	477,705	508,537
Total liabilities and shareholders equity	$ 4,291,804	$ 3,841,015	$ 4,120,531

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 June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
INTEREST INCOME:				
Interest and fees on loans	$ 25,014	$ 24,633	$ 49,654	$ 48,920
Interest on investment securities:				
Taxable	8,214	9,831	17,018	19,423
Exempt from federal income tax	6,456	5,459	12,598	10,940
Interest on federal funds sold and interest-bearing deposits in banks	227	318	438	685
Total interest income	39,911	40,241	79,708	79,968
INTEREST EXPENSE:				
Interest on deposits	1,310	2,014	2,793	4,364
Other	45	51	102	102
Total interest expense	1,355	2,065	2,895	4,466
Net interest income	38,556	38,176	76,813	75,502
PROVISION FOR LOAN LOSSES	759	1,924	2,055	4,051
Net interest income after provision for loan losses	37,797	36,252	74,758	71,451
NONINTEREST INCOME:				
Trust fees	3,670	3,211	7,124	6,254
Service charges on deposit accounts	4,042	4,520	7,924	8,894
ATM, interchange and credit card fees	3,784	3,415	7,460	6,491
Real estate mortgage operations	1,218	941	2,268	1,874
Net gain on available-for-sale securities	382	42	728	261
Net gain (loss) on sale of foreclosed assets	(404)	(1,111)	(406)	(1,174)
Other	772	876	1,664	2,136
Total noninterest income	13,464	11,894	26,762	24,736
NONINTEREST EXPENSE:				
Salaries and employee benefits	14,189	14,008	28,418	28,243
Net occupancy expense	1,743	1,685	3,480	3,332
Equipment expense	2,144	1,951	4,252	3,822
FDIC insurance premiums	565	597	1,093	1,568
ATM, interchange and credit card expenses	1,450	1,183	2,699	2,330
Professional and service fees	689	834	1,426	1,834
Printing, stationery and supplies	511	489	1,015	916
Amortization of intangible assets	38	105	82	216
Other	5,416	5,036	10,748	9,787
Total noninterest expense	26,745	25,888	53,213	52,048

EARNINGS BEFORE INCOME TAXES	24,516	22,258	48,307	44,139
INCOME TAX EXPENSE	6,165	5,738	12,200	11,324
NET EARNINGS	$ 18,351	$ 16,520	$ 36,107	$ 32,815
EARNINGS PER SHARE, BASIC	$ 0.58	$ 0.53	$ 1.15	$ 1.04
EARNINGS PER SHARE, ASSUMING DILUTION	$ 0.58	$ 0.52	$ 1.15	$ 1.04
DIVIDENDS PER SHARE	$ 0.25	$ 0.24	$ 0.49	$ 0.47

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 June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
NET EARNINGS	$ 18,351	$ 16,520	$ 36,107	$ 32,815
OTHER ITEMS OF COMPREHENSIVE EARNINGS:				
Change in unrealized gain on investment securities available-for-sale, before income taxes	10,536	18,689	7,448	26,186
Reclassification adjustment for realized gains on investment securities included in net earnings, before income tax	(382)	(42)	(728)	(261)
Total other items of comprehensive earnings	10,154	18,647	6,720	25,925
Income tax expense related to other items of comprehensive earnings	(3,554)	(6,526)	(2,352)	(9,074)
COMPREHENSIVE EARNINGS	$ 24,951	$ 28,641	$ 40,475	$ 49,666

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 Amounts	Deferred Compensation	Accumulated Other Comprehensive Earnings	Total Shareholders Equity
Balances at December 31, 2010	20,942,141	$ 209	$ 274,629	$ 146,397	(166,329)	$ (4,207)	$ 4,207	$ 20,453	$ 441,688
Net earnings (unaudited)				32,815					32,815
Stock issuances (unaudited)	27,982		804						804
Cash dividends declared, $0.47 per share (unaudited)				(14,690)					(14,690)
Change in unrealized gain in investment securities available-for-sale, net of related income taxes (unaudited)								16,851	16,851
Additional tax benefit related to directors deferred compensation plan (unaudited)			20						20
Shares purchased in connection with directors deferred compensation plan, net (unaudited)					(2,041)	(187)	187		
Stock option expense (unaudited)			217						217
Three-for-two stock split in the form of a 50% stock dividend (unaudited)	10,481,177	105		(105)	(83,146)				
Balances at June 30, 2011 (unaudited)	31,451,300	$ 314	$ 275,670	$ 164,417	(251,516)	$ (4,394)	$ 4,394	$ 37,304	$ 477,705
Balances at December 31, 2011	31,459,635	$ 314	$ 276,127	$ 184,871	(258,235)	$ (4,597)	$ 4,597	$ 47,225	$ 508,537
Net earnings (unaudited)				36,107					36,107
Stock issuances (unaudited)	22,112	1	481						482
Cash dividends declared, $0.49 per share (unaudited)				(15,424)					(15,424)
Change in unrealized gain in investment securities available-for-sale, net of related income taxes (unaudited)								4,368	4,368
Additional tax benefit related to directors deferred compensation			20						20

plan (unaudited)									
Shares purchased in connection with directors deferred compensation plan, net (unaudited)					(5,682)	(166)	166		
Stock option expense (unaudited)			173						173
Balances at June 30, 2012 (unaudited)	31,481,747	$ 315	$ 276,801	$ 205,554	(263,917)	$ (4,763)	$ 4,763	$ 51,593	$ 534,263

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)

	Six Months Ended June 30, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$ 36,107	$ 32,815
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	3,913	3,600
Provision for loan losses	2,055	4,051
Securities premium amortization (discount accretion), net	7,659	3,392
Loss (gain) on sale of assets, net	(555)	647
Deferred federal income tax expense (benefit)	(627)	(160)
Change in loans held for sale	952	8,903
Change in other assets	991	376
Change in other liabilities	5,471	3,125
Total adjustments	19,859	23,934
Net cash provided by operating activities	55,966	56,749
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease (increase) in interest-bearing time deposits in banks	(13,419)	25,374
Activity in available-for-sale securities:		
Sales	68,961	12,436
Maturities	162,251	168,863
Purchases	(314,770)	(265,097)
Activity in held-to-maturity securities - maturities	2,150	2,402
Net increase in loans	(134,677)	(42,302)
Purchases of bank premises and equipment and other assets	(8,525)	(6,437)
Proceeds from sale of other assets	3,222	1,495
Net cash used in investing activities	(234,807)	(103,266)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in noninterest-bearing deposits	54,662	29,797
Net increase (decrease) in interest-bearing deposits	2,720	(23,658)
Net increase in short-term borrowings	43,672	14,008
Common stock transactions:		
Proceeds from stock issuances	482	805
Dividends paid	(15,103)	(14,231)
Net cash provided by financing activities	86,433	6,721
NET DECREASE IN CASH AND CASH EQUIVALENTS	(92,408)	(39,796)
CASH AND CASH EQUIVALENTS, beginning of period	250,836	264,267
CASH AND CASH EQUIVALENTS, end of period	$ 158,428	$ 224,471

SUPPLEMENTAL INFORMATION AND NONCASH TRANSACTIONS		
Interest paid	$ 3,096	$ 4,927
Federal income tax paid	8,975	9,231
Transfer of loans to foreclosed assets	614	2,581
Investment securities purchased but not settled	58,496	11,168

See notes to consolidated financial statements.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

The interim 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 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 Financial Bank, Huntsville, 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. Most of our service centers are located in North Central and West Texas. Including the branches and locations of all our bank subsidiaries, as of June 30, 2012, we had 53 financial centers across Texas, with ten locations in Abilene, two locations in Cleburne, two 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, Cisco, Southlake, Grapevine, Aledo, Willow Park, Brock, Alvarado, Burleson, Keller, Trophy Club, Boyd, Bridgeport, Decatur, Roby, Trent, Merkel, Clyde, Moran, Albany, Midlothian, Crowley, Glen Rose, Odessa, Fort Worth and Huntsville. Our trust subsidiary has six locations which consist of Abilene, San Angelo, Stephenville, Sweetwater, Fort Worth and Odessa, all in Texas.

In the opinion of management, the unaudited interim consolidated financial statements reflect all adjustments necessary for a fair presentation of the Company financial position and unaudited results of operations and should be read in conjunction with the Company s audited consolidated financial statements, and notes thereto in the Company s Annual Report on Form 10-K, for the year ended December 31, 2011. All adjustments were of a normal recurring nature. However, the results of operations for the three and six months ended June 30, 2012, are not necessarily indicative of the results to be expected for the year ending December 31, 2012, 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.

On April 26, 2011, the Company s Board of Directors declared a three-for-two stock split in the form of a 50% stock dividend effective for shareholders of record on May 16, 2011 that was distributed on June 1, 2011. All share and per share amounts in this report, prior to split, have been restated to reflect this stock split. An amount equal to the par value of the additional common shares issued pursuant to the stock split was reflected as a transfer from retained earnings to common stock on the consolidated financial statements as of and for the three and six months ended June 30, 2011.

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On October 26, 2011, the Company s Board of Directors authorized the repurchase of up to 750,000 common shares through September 30, 2014. The stock buyback plan authorizes management to repurchase the stock at such time as repurchases are considered beneficial to stockholders. Any repurchase of stock will be made through the open market, block trades or in privately negotiated transactions in accordance with applicable laws and regulations. Under the repurchase plan, there is no minimum number of shares that the Company is required to repurchase. Through June 30, 2012, no shares have been repurchased under this authorization.

On April 24, 2012, the Company s shareholders approved an amendment to the Company s Amended and Restated Certificate of Formation to increase the number of authorized common shares to 80,000,000.

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 the current or any prior 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 and six months ended June 30, 2012 and 2011, the Company assumes that all dilutive outstanding options to purchase common stock have been exercised at the beginning of the period (or the time of issuance, if later). The dilutive effect of the outstanding options is reflected by application of the treasury stock method, whereby the proceeds from the exercised options are assumed to be used to purchase common stock at the average market price during the respective periods. The weighted average common shares outstanding used in computing basic earnings per common share for the three months ended June 30, 2012 and 2011, were 31,478,980 and 31,442,978 shares, respectively. The weighted average common shares outstanding used in computing basic earnings per common share for the six months ended June 30, 2012 and 2011, were 31,472,843 and 31,434,328 respectively. The weighted average common shares outstanding used in computing fully diluted earnings per common share for the three months ended June 30, 2012 and 2011, were 31,497,241 and 31,467,617 shares, respectively. The weighted average common shares outstanding used in computing fully diluted earnings per common share for the six months ended June 30, 2012 and 2011, were 31,474,653 and 31,457,286, respectively.

Note 3 Interest-bearing Time Deposits in Banks and Securities

Interest-bearing time deposits with banks totaled $74.6 million and $61.2 million at June 30, 2012 and December 31, 2011 respectively, and have original maturities generally ranging from one to two years. Of these amounts, $65.4 million and $51.8 million are time deposits with balances greater than $100,000 at June 30, 2012 and December 31, 2011, respectively.

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

Management classifies debt and equity securities as held-to-maturity, available-for-sale, or trading based on its intent. Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income using the interest method. Securities not classified as held-to-maturity or trading are classified as available-for-sale and recorded at estimated fair value, with all unrealized gains and unrealized losses judged to be temporary, net of deferred income taxes, excluded from earnings and reported as a separate component of shareholders equity. Available- for-sale securities that have unrealized losses that are judged other than temporary are included in gain (loss) on sale of securities and a new cost basis is established. Securities classified as trading are recorded at estimated fair value with unrealized gains and losses included in earnings.

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

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

The Company utilizes independent third party pricing services to value its investment securities. The Company reviews the prices supplied by the independent pricing services as well as the underlying pricing methodologies for reasonableness and to ensure such prices are aligned with traditional pricing matrices. The Company s investment portfolio consists of traditional investments, substantially all in U.S. Treasury securities, obligations of U.S. government sponsored-enterprises and agencies, mortgage pass-through securities, corporate bonds and general obligation or revenue based municipal bonds. Pricing for such securities is generally readily available and transparent in the market. The Company validates quarterly, on a sample basis, prices supplied by the independent pricing services by comparison to prices obtained from other third party sources.

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

	June 30, 2012			
	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ 11,092	$ 116	$	$ 11,208
Obligations of U.S. government sponsored-enterprises and agencies	255,802	4,890		260,692
Obligations of states and political subdivisions	776,421	56,415	(524)	832,312
Corporate bonds and other	127,836	5,570	(70)	133,336
Mortgage-backed securities	700,086	24,799	(525)	724,360
Total securities available-for-sale	$ 1,871,237	$ 91,790	$ (1,119)	$ 1,961,908
Securities held-to-maturity:				
Obligations of states and political subdivisions	$ 1,084	$ 11	$	$ 1,095
Mortgage-backed securities	375	15		390
Total debt securities held-to-maturity	$ 1,459	$ 26	$	$ 1,485

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	December 31, 2011			
	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ 15,143	$ 204	$	$ 15,347
Obligations of U.S. government sponsored-enterprises and agencies	255,548	5,802	(4)	261,346
Obligations of states and political subdivisions	655,957	48,812	(98)	704,671
Corporate bonds and other	127,514	4,215	(255)	131,474
Mortgage-backed securities	703,280	25,360	(89)	728,551
Total securities available-for-sale	$ 1,757,442	$ 84,393	$ (446)	$ 1,841,389
Securities held-to-maturity:				
Obligations of states and political subdivisions	$ 3,187	$ 30	$	$ 3,217
Mortgage-backed securities	422	16		438
Total debt securities held-to-maturity	$ 3,609	$ 46	$	$ 3,655

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 June 30, 2012, were computed by using scheduled amortization of balances and historical prepayment rates. At June 30, 2012 and December 31, 2011, 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 June 30, 2012, by contractual and expected maturity, are shown below (in thousands):

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost Basis	Estimated Fair Value	Amortized Cost Basis	Estimated Fair Value
Due within one year	$ 157,548	$ 160,428	$ 1,004	$ 1,010
Due after one year through five years	487,090	506,296	80	85
Due after five years through ten years	514,328	555,823		
Due after ten years	12,185	15,001		
Mortgage-backed securities	700,086	724,360	375	390
Total	$ 1,871,237	$ 1,961,908	$ 1,459	$ 1,485

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The following tables disclose, as of June 30, 2012 and December 31, 2011, the Company s investment securities that have been in a continuous unrealized-loss position for less than 12 months and for 12 or more months (in thousands):

	Less than 12 Months		12 Months or Longer		Total	
June 30, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of states and political subdivisions	$ 52,234	$ 524	$	$	$ 52,234	$ 524
Corporate bonds and other	5,010	70			5,010	70
Mortgage-backed securities	53,675	476	3,880	49	57,555	525
Total	$ 110,919	$ 1,070	$ 3,880	$ 49	$ 114,799	$ 1,119

	Less than 12 Months		12 Months or Longer		Total	
December 31, 2011	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of U.S. government sponsored-enterprises and agencies	$ 3,114	$ 4	$	$	$ 3,114	$ 4
Obligations of states and political subdivisions	9,595	98			9,595	98
Corporate bonds and other	17,533	255			17,533	255
Mortgage-backed securities	13,722	89			13,722	89
Total	$ 43,964	$ 446	$	$	$ 43,964	$ 446

The number of investment positions in this unrealized loss position totaled 136 at June 30, 2012. We do not believe these unrealized losses are other than temporary as (i) we do not have the intent to sell our securities prior to recovery and/or maturity and (ii) it is more likely than not that we will not have to sell our securities prior to recovery and/or maturity. In making the determination, we also consider the length of time and extent to which fair value has been less than cost and the financial condition of the issuer. The unrealized losses noted are interest rate related due to the level of interest rates at June 30, 2012 compared to the time of purchase. 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.

Securities, carried at approximately $870.4 million at June 30, 2012, were pledged as collateral for public or trust fund deposits, repurchase agreements and for other purposes required or permitted by law.

During the quarter ended June 30, 2012 and 2011, sales of investment securities that were classified as available-for-sale totaled $48.0 million and $1.2 million, respectively. Gross realized gains from securities sales and calls during the second quarter of 2012 and 2011 totaled $382 thousand and $43 thousand, respectively. Gross realized losses from securities sales and calls during the second quarter of 2012 and 2011 totaled $1 thousand and $1 thousand, respectively. During the six-months ended June 30, 2012 and 2011, sales of investment securities that were classified as available-for-sale totaled $69.0 million and $12.4 million, respectively. Gross realized gains for securities sales and calls during the six-month period ended June 30, 2012 and 2011 totaled $728 thousand and $274 thousand, respectively. Gross realized losses from sales during the six-month period ended June 30, 2012 and 2011 totaled $1 thousand and $13 thousand, respectively. The specific identification method was used to determine cost in order to compute the realized gains and losses.

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Note 4 Loans and Allowance for Loan Losses

Loans held for investment are stated at the amount of unpaid principal, reduced by unearned income and an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amounts outstanding. The Company defers and amortizes net loan origination fees and costs as an adjustment to yield. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes the collectability of the principal is unlikely.

The Company has certain lending policies and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis and makes changes as appropriate. Management receives and reviews frequent reports related to loan originations, quality, concentrations, delinquencies, non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geographically.

Commercial loans are underwritten after evaluating and understanding the borrower s ability to operate profitably and effectively. Underwriting standards are designed to determine whether the borrower possesses sound business ethics and practices and to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory and include personal guarantees.

Agricultural loans are subject to underwriting standards and processes similar to commercial loans. These agricultural loans are based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most agricultural loans are secured by the agriculture related assets being financed, such as farm land, cattle or equipment and include personal guarantees.

Real estate loans are also subject to underwriting standards and processes similar to commercial and agricultural loans. These loans are underwritten primarily based on projected cash flows and, secondarily, as loans secured by real estate. The repayment of real estate loans is generally largely dependent on the successful operation of the property securing the loans or the business conducted on the property securing the loan. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company s real estate portfolio are generally diverse in terms of type and geographic location. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry. Generally, real estate loans are owner occupied which further reduces the Company s risk.

Consumer loan underwriting utilizes methodical credit standards and analysis to supplement the Company s underwriting policies and procedures. The Company s loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimize the Company s risk.

The allowance is an amount management believes is appropriate to absorb probable losses that have been incurred on existing loans as of the balance sheet date based upon management s review and evaluation of the loan portfolio. The allowance for loan losses is comprised of three elements: (i) specific reserves determined in accordance with current authoritative accounting guidance based on probable losses on specific classified loans; (ii) general reserve determined in accordance with current authoritative accounting guidance that considers historical loss rates; and (iii) qualitative reserves determined in accordance with current authoritative accounting guidance based upon general economic conditions and other qualitative risk factors both internal and external to the Company. The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries). Management s periodic evaluation of the appropriateness of the allowance is based on general economic conditions, the financial condition of borrowers, the value and liquidity of collateral, delinquency, prior loan loss experience, and the results of periodic reviews of the portfolio. For purposes of determining our general reserve, the loan portfolio, less cash secured loans, government guaranteed loans and classified loans, is multiplied by the Company s historical loss rate. Our methodology is constructed so that specific allocations are increased in accordance with deterioration in credit quality and a corresponding increase in risk of loss. In addition, we adjust our allowance for qualitative factors such as current local economic conditions and trends, including, without limitations, unemployment, changes in lending staff, policies and procedures, changes in credit concentrations, changes in the trends and severity of problem loans and changes in trends in volume and terms of loans. This additional allocation based on qualitative factors serves to compensate for additional areas of uncertainty inherent in our portfolio that are not reflected in our historic loss factors.

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

Accrual of interest is discontinued on a loan and payments are applied to principal when management believes, after considering economic and business conditions and collection efforts, the borrower s financial condition is such that collection of interest is doubtful. Except consumer loans, generally all loans, past due greater than 90 days, based on contractual terms, are placed on non-accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Consumer loans are generally charged-off when a loan becomes past due 90 days. For other loans in the portfolio, facts and circumstances are evaluated in making charge-off decisions.

Loans are considered impaired when, based on current information and events, it is probable we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectable.

The Company s policy requires measurement of the allowance for an impaired, collateral dependent loan based on the fair value of the collateral. Other loan impairments are measured based on the present value of expected future cash flows or the loan s observable market price. At June 30, 2012 and 2011, and December 31, 2011, all significant impaired loans have been determined to be collateral dependent and the allowance for loss has been measured utilizing the estimated fair value of the collateral.

From time to time, the Company modifies its loan agreement with a borrower. A modified loan is considered a troubled debt restructuring when two conditions are met: (i) the borrower is experiencing financial difficulty and (ii) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit risk characteristics. Modifications to loan terms may include a lower interest rate, a reduction of principal, or a longer term to maturity. To date, these troubled debt restructurings have been such that, after considering economic and business conditions and collection efforts, the collection of interest is doubtful and therefore the loan has been placed on non-accrual. Each of these loans is evaluated for impairment and a specific reserve is recorded based on probable losses,

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taking into consideration the related collateral and modified loan terms and cash flow. As of June 30, 2012 and 2011, and December 31, 2011, all of the Company s troubled debt restructured loans are included in the non-accrual totals.

The Company originates certain mortgage loans for sale in the secondary market. Accordingly, these loans are classified as held for sale and are carried at the lower of cost or fair value on an aggregate basis. The mortgage loan sales contracts contain indemnification clauses should the loans default, generally in the first three to six months or if documentation is determined not to be in compliance with regulations. The Company s historic losses as a result of these indemnities have been insignificant.

Loans acquired, including loans acquired in a business combination, that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all amounts contractually owed are initially recorded at fair value with no valuation allowance. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, is recognized as interest income on a level-yield method over the life of the loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, are not recognized as a yield adjustment. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as impairment. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition.

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

	June 30,		December 31,
	2012	2011	2011
Commercial	$ 479,697	$ 439,477	$ 454,087
Agricultural	51,822	61,083	68,122
Real estate	1,143,031	1,012,539	1,041,396
Consumer	234,065	202,060	212,310
Total loans held for investment	$ 1,908,615	$ 1,715,159	$ 1,775,915

Certain amounts above for December 31, 2011 have been reclassified from prior presentation to be consistent with June 30, 2012 and 2011 presentation.

Loans held for sale totaled $9.7 million, $4.3 million and $10.6 million, at June 30, 2012 and 2011 and December 31, 2011, respectively, in which the carrying amounts approximate fair value.

The Company s non-accrual loans, loans still accruing and past due 90 days or more and restructured loans are as follows (in thousands):

	June 30,		December 31,
	2012	2011	2011
Non-accrual loans	$ 26,606	$ 18,599	$ 19,975
Loans still accruing and past due 90 days or more	105	6	96
Restructured loans*			
Total	$ 26,711	$ 18,605	$ 20,071

* Restructured loans whose interest collection, after considering economic and business conditions and collection efforts, is doubtful are included in non-accrual loans.

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

June 30, 2012		June 30, 2011		December 31, 2011	
Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
$ 26,606	$ 7,473	$ 18,599	$ 3,170	$ 19,975	$ 5,953

The average recorded investment in impaired loans for the quarter and six months ended June 30, 2012 and the year ended December 31, 2011 was approximately $27.4 million, $28.0 million and $22.3 million, respectively. The Company had $33.9 million, $27.4 million and $29.5 million in non-accrual, past due 90 days still accruing and restructured loans and foreclosed assets at June 30, 2012 and 2011, and December 31, 2011, respectively. Non-accrual loans totaled $26.6 million, $18.6 million and $20.0 million, respectively, of this amount and consisted of (in thousands):

	June 30, 2012	June 30, 2011	December 31, 2011
Commercial	$ 4,427	$ 1,419	$ 3,450
Agricultural	446	407	145
Real estate	21,520	16,563	16,193
Consumer	213	210	187
Total	$ 26,606	$ 18,599	$ 19,975

No additional funds are committed to be advanced in connection with impaired loans.

The Company s impaired loans and related allowance as of June 30, 2012 and December 31, 2011 are summarized in the following table (in thousands). No interest income was recognized on impaired loans subsequent to their classification as impaired.

June 30, 2012	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Year-to-Date Average Recorded Investment
Commercial	$ 5,067	$ 30	$ 4,397	$ 4,427	$ 2,122	$ 4,635
Agricultural	470	2	444	446	138	487
Real Estate	25,043	2,038	19,482	21,520	5,109	22,668
Consumer	263	13	200	213	104	244
Total	$ 30,843	$ 2,083	$ 24,523	$ 26,606	$ 7,473	$ 28,034

December 31, 2011	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Year-to-Date Average Recorded Investment
Commercial	$ 3,856	$	$ 3,450	$ 3,450	$ 2,092	$ 3,801
Agricultural	199	3	142	145	79	246

Real Estate	19,305	1,786	14,407	16,193	3,708	18,068
Consumer	227	29	158	187	74	233
Total	$ 23,587	$ 1,818	$ 18,157	$ 19,975	$ 5,953	$ 22,348

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The Company recognized interest income on impaired loans of approximately $1.1 million during the year ended December 31, 2011. Such amounts for the quarters and six-month periods ended June 30, 2012 and 2011 were not significant.

From a credit risk standpoint, the Company classifies its loans in one of four categories: (i) pass, (ii) special mention, (iii) substandard, or (iv) doubtful. Loans classified as loss are charged-off.

The classifications of loans reflect a judgment about the risks of default and loss associated with the loan. The Company reviews the ratings on our credits as part of our on-going monitoring of the credit quality of our loan portfolio. Ratings are adjusted to reflect the degree of risk and loss that are felt to be inherent in each credit as of each monthly reporting period. Our methodology is structured so that specific allocations are increased in accordance with deterioration in credit quality (and a corresponding increase in risk and loss) or decreased in accordance with improvement in credit quality (and a corresponding decrease in risk and loss).

Credits rated special mention show clear signs of financial weaknesses or deterioration in credit worthiness, however, such concerns are not so pronounced that the Company generally expects to experience significant loss within the short-term. Such credits typically maintain the ability to perform within standard credit terms and credit exposure is not as prominent as credits rated more harshly.

Credits rated substandard are those in which the normal repayment of principal and interest may be, or has been, jeopardized by reason of adverse trends or developments of a financial, managerial, economic or political nature, or important weaknesses exist in collateral. A protracted workout on these credits is a distinct possibility. Prompt corrective action is therefore required to strengthen the Company s position, and/or to reduce exposure and to assure that adequate remedial measures are taken by the borrower. Credit exposure becomes more likely in such credits and a serious evaluation of the secondary support to the credit is performed.

Credits rated doubtful are those in which full collection of principal appears highly questionable, and which some degree of loss is anticipated, even though the ultimate amount of loss may not yet be certain and/or other factors exist which could affect collection of debt. Based upon available information, positive action by the Company is required to avert or minimize loss. Credits rated doubtful are generally also placed on non-accrual.

At June 30, 2012 and December 31, 2011, the following summarizes the Company s internal ratings of its loans held for investment (in thousands):

June 30, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 462,465	$ 5,024	$ 12,208	$	$ 479,697
Agricultural	48,372	1,000	2,440	10	51,822
Real Estate	1,084,065	17,439	41,384	143	1,143,031
Consumer	232,856	462	735	12	234,065
Total	$ 1,827,758	$ 23,925	$ 56,767	$ 165	$ 1,908,615

December 31, 2011	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 432,110	$ 9,227	$ 12,748	$ 2	$ 454,087
Agricultural	65,007	347	2,755	13	68,122
Real Estate	980,308	20,922	40,068	98	1,041,396
Consumer	211,177	302	820	11	212,310
Total	$ 1,688,602	$ 30,798	$ 56,391	$ 124	$ 1,775,915

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At June 30, 2012 and December 31, 2011, the Company s past due loans are as follows (in thousands):

June 30, 2012	15-59 Days Past Due*	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	90 Days Past Due Still Accruing
Commercial	$ 4,267	$ 14	$ 366	$ 4,647	$ 475,050	$ 479,697	$ 105
Agricultural	97			97	51,725	51,822	
Real Estate	10,579	603	2,771	13,953	1,129,078	1,143,031	
Consumer	1,189	35	32	1,256	232,809	234,065	
Total	$ 16,132	$ 652	$ 3,169	$ 19,953	$ 1,888,662	$ 1,908,615	$ 105

December 31, 2011	15-59 Days Past Due*	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	90 Days Past Due Still Accruing
Commercial	$ 1,574	$ 430	$	$ 2,004	$ 452,083	$ 454,087	$
Agricultural	300	60		360	67,762	68,122	
Real Estate	10,215	547	988	11,750	1,029,646	1,041,396	62
Consumer	1,396	128	47	1,571	210,739	212,310	34
Total	$ 13,485	$ 1,165	$ 1,035	$ 15,685	$ 1,760,230	$ 1,775,915	$ 96

* The Company monitors commercial, agricultural and real estate loans after such loans are 15 days past due. Consumer loans are monitored after such loans are 30 days past due.

The allowance for loan losses as of June 30, 2012 and 2011, and December 31, 2011, is presented below. Management has evaluated the adequacy of the allowance for loan losses by estimating the probable losses in various categories of the loan portfolio, which are identified below (in thousands):

	June 30, 2012	June 30, 2011	December 31, 2011
Allowance for loan losses provided for:			
Loans specifically evaluated as impaired	$ 7,473	$ 3,170	$ 5,953
Remaining portfolio	27,274	30,236	28,362
Total allowance for loan losses	$ 34,747	$ 33,406	$ 34,315

The following table details the allowance for loan losses at June 30, 2012 and December 31, 2011 by portfolio segment (in thousands). Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

June 30, 2012	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 4,124	$ 477	$ 9,301	$ 267	$ 14,169
Loans collectively evaluated for impairment	4,432	776	13,993	1,377	20,578
Total	$ 8,556	$ 1,253	$ 23,294	$ 1,644	$ 34,747

December 31, 2011	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 4,647	$ 758	$ 8,310	$ 282	$ 13,997
Loans collectively evaluated for impairment	5,017	724	13,223	1,354	20,318
Total	$ 9,664	$ 1,482	$ 21,533	$ 1,636	$ 34,315

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Changes in the allowance for loan losses for the three and six months ended June 30, 2012 and 2011 are summarized as follows (in thousands):

Three months ended June 30, 2012	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning balance	$ 9,612	$ 1,353	$ 21,835	$ 1,729	$ 34,529
Provision for loan losses	(941)	(79)	1,679	100	759
Recoveries	49	10	64	102	225
Charge-offs	(164)	(31)	(284)	(287)	(766)
End balance	$ 8,556	$ 1,253	$ 23,294	$ 1,644	$ 34,747

Three months ended June 30, 2011	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning balance	$ 8,652	$ 1,151	$ 20,962	$ 1,736	$ 32,501
Provision for loan losses	(78)	614	1,276	112	1,924
Recoveries	39	1	245	92	377
Charge-offs	(46)		(1,089)	(261)	(1,396)
End balance	$ 8,567	$ 1,766	$ 21,394	$ 1,679	$ 33,406

Six months ended June 30, 2012	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning balance	$ 9,664	$ 1,482	$ 21,533	$ 1,636	$ 34,315
Provision for loan losses	(847)	(197)	2,839	260	2,055
Recoveries	152	21	178	197	548
Charge-offs	(413)	(53)	(1,256)	(449)	(2,171)
End balance	$ 8,556	$ 1,253	$ 23,294	$ 1,644	$ 34,747

Six months ended June 30, 2011	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning balance	$ 7,745	$ 2,299	$ 19,101	$ 1,961	$ 31,106
Provision for loan losses	796	(564)	3,805	14	4,051
Recoveries	73	31	352	199	655
Charge-offs	(47)		(1,864)	(495)	(2,406)
End balance	$ 8,567	$ 1,766	$ 21,394	$ 1,679	$ 33,406

The Company s recorded investment in loans as of June 30, 2012 and December 31, 2011 related to the balance in the allowance for loan losses on the basis of the Company s impairment methodology was as follows (in thousands):

June 30, 2012	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 17,233	$ 3,450	$ 58,966	$ 1,208	$ 80,857
Loans collectively evaluated for impairment	462,464	48,372	1,084,065	232,857	1,827,758
Total	$ 479,697	$ 51,822	$ 1,143,031	$ 234,065	$ 1,908,615

December 31, 2011	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 21,977	$ 3,115	$ 61,088	$ 1,133	$ 87,313
Loans collectively evaluated for impairment	432,110	65,007	980,308	211,177	1,688,602
Total	$ 454,087	$ 68,122	$ 1,041,396	$ 212,310	$ 1,775,915

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The Company s loans that were modified in the three and six months ended June 30, 2012 and considered a troubled debt restructuring are as follows (dollars in thousands):

Three months ended June 30, 2012	Number	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial	6	$ 721	$ 721
Agricultural	3	245	245
Real Estate	13	3,805	3,805
Consumer	1	19	19
Total	23	$ 4,790	$ 4,790

Six months ended June 30, 2012	Number	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial	10	$ 848	$ 848
Agricultural	5	354	354
Real Estate	26	7,607	7,607
Consumer	1	19	19
Total	42	$ 8,828	$ 8,828

The balances below provide information as to how the loans were modified as troubled debt restructured loans during the three and six months ended June 30, 2012 (in thousands):

Three months ended June 30, 2012	Adjusted Interest Rate	Extended Maturity	Combined Rate and Maturity
Commercial	$ 492	$ 58	$ 171
Agricultural	243	3	
Real Estate	935	1,107	1,762
Consumer		19	
Total	$ 1,670	$ 1,187	$ 1,933

Six months ended June 30, 2012	Adjusted Interest Rate	Extended Maturity	Combined Rate and Maturity
Commercial	$ 509	$ 120	$ 219
Agricultural	243	16	95
Real Estate	935	1,107	5,565
Consumer		19	
Total	$ 1,687	$ 1,262	$ 5,879

There were no loans modified as a troubled debt restructured loan within the previous 12 months and for which there was a payment default during the three and six months ended June 30, 2012. A default for purposes of this disclosure is a troubled debt restructured loan in which the borrower is 90 days past due or results in the foreclosure and repossession of the applicable collateral.

As of June 30, 2012, the Company has no commitments to lend additional funds to loan customers whose terms have been modified in troubled debt restructurings.

Certain of our subsidiary banks have established lines of credit with the Federal Home Loan Bank of Dallas to provide liquidity and meet pledging requirements for those customers eligible to have securities pledged to secure certain uninsured deposits. At June 30, 2012, approximately $737.6 million in loans held by these subsidiaries were subject to blanket liens as security for these lines of credit. At June 30, 2012, $80.7 million in letters of credit issued by the Federal Home Loan Bank of Dallas were outstanding under these lines of credit. These letters of credit were pledged as collateral for public funds held by our subsidiary banks.

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Note 5 Income Taxes

Income tax expense was $6.2 million for the second quarter in 2012 as compared to $5.7 million for the same period in 2011. Our effective tax rates on pretax income were 25.1% and 25.8% for the second quarter of 2012 and 2011, respectively. Income tax expense was $12.2 for the six months ended June 30, 2012 as compared to $11.3 for the same period in 2011. Our effective tax rates on pretax income were 25.2% and 25.7% for the six months ended June 30, 2012 and 2011, 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.

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. Options totaling 156,100 shares were granted in October 2011 at an exercise price of $31.45. The weighted average grant-date fair value of these options granted was $5.94. No options have been granted in 2012. The Company recorded stock option expense totaling approximately $85 thousand and $109 thousand, for the three-month periods ended June 30, 2012 and 2011, respectively. The Company recorded stock option expense totaling approximately $173 thousand and $217 thousand, respectively, for the six-month periods ended June 30, 2012 and 2011. 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 at the time. 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 has evaluated the provisions of the Protection Act as well as the Internal Revenue Service s funding standards to develop a plan for funding in future years. The Company made a contribution totaling $1.0 million in both March 2012 and March 2011 and continues to evaluate future funding amounts.

Net periodic benefit costs totaling $185 thousand and $150 thousand were recorded, respectively, for the three months ended June 30, 2012 and 2011. Net periodic benefit costs totaling $370 thousand and $299 thousand were recorded, respectively, for the six months ended June 30, 2012 and 2011.

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Note 8 Recently Issued Authoritative Accounting Guidance

In 2011, the FASB amended its authoritative guidance to require that all changes in stockholders equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, the authoritative guidance requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholder s equity was eliminated. The new guidance was effective January 1, 2012, although certain provisions in the guidance have been deferred to allow the FASB time to re-deliberate. The new guidance did not have a significant impact on the Company s financial statements.

In 2011, the FASB amended its authoritative guidance related to goodwill impairment to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. The new guidance is effective for annual and interim impairment tests in 2012, and did not have a significant impact on the Company s financial statements.

In 2011, the FASB amended its authoritative guidance related to fair value measurements and disclosures to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendment clarifies the application of existing fair value measurement requirements, changes certain principles in existing literature and requires additional fair value disclosures. The new guidance was effective January 1, 2012 and did not have a significant impact on the Company s financial statement, except for additional disclosures.

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

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market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, 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 market spreads, cash flows, the United States Treasury yield curve, live trading levels, trade execution data, dealer quotes, market consensus prepayments speeds, credit information and the security s terms and conditions, among other items. Securities are considered to be measured with Level 1 inputs at the time of purchase and for 30 days following. After 30 days, the majority of securities are transferred to Level 2 as they are considered to be measured with Level 2 inputs, with the exception of U.S. Treasury securities and any other security for which there remain Level 1 inputs. Transfers are recognized on the actual date of transfer.

There were no transfers between Level 2 and Level 3 during the three and six months ended June 30, 2012 or 2011.

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The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2012, 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	$ 11,208	$	$	$ 11,208
Obligations of U.S. government sponsored-enterprises and agencies		260,692		260,692
Obligations of states and political subdivisions	48,042	784,270		832,312
Corporate bonds		129,399		129,399
Mortgage-backed securities	38,028	686,332		724,360
Other securities	3,937			3,937
Total	$ 101,215	$ 1,860,693	$	$ 1,961,908

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis include the following at June 30, 2012:

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, generally third party appraisals, or Level 3 input based on customized discounting criteria. These appraisals are evaluated individually and discounts are made as necessary due to the age of the appraisal, lack of comparable sales, existence of superior liens and property taxes or special use type of property. Such discounts vary by appraisal based on the above factors but generally range from 5% to 25% of the appraised value. At June 30, 2012, impaired loans with a carrying value of $26.6 million were reduced by specific valuation allowances totaling $7.5 million resulting in a net fair value of $19.1 million, based on Level 3 inputs.

Loans Held for Sale Loans held for sale are reported at the lower of cost or fair value. In determining whether the fair value of loans held for sale is less than cost when quoted market prices are not available, the Company considers investor commitments/contracts. These loans are considered Level 2 of the fair value hierarchy. At June 30, 2012, 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 non-recurring basis include other real estate owned, goodwill and other intangible assets and other non-financial long-lived assets. Non-financial assets measured at fair value on a non-recurring basis during the three and six months ended June 30, 2012 and 2011 include other real estate owned which, subsequent to their initial transfer to other real estate owned from loans, were re-measured at fair value through a write-down included in gain (loss) on sale of foreclosed assets. During the reported periods, all fair value measurements for foreclosed assets utilized Level 2 inputs based on observable market data, generally third-party appraisals, or Level 3 inputs based on customized discounting criteria. These appraisals are evaluated individually and discounts are as necessary due to the age of the appraisal, lack of comparable sales, expected holding periods of property or special use type of the property. Such discounts vary by appraisal based on the above factors but generally range from 5% to 25% of the appraised value. Reevaluation of other real estate owned is performed at least annually as required by regulatory guidelines or more often if particular circumstances arise. The following table presents other real estate owned that were re-measured subsequent to their initial transfer to other real estate owned from loans and reported at fair value (dollars in thousands):

	Three months ended June 30,	
	2012	2011
Carrying value of other real estate owned prior to re-measurement	$ 4,226	$ 4,404
Write-downs included in gain (loss) on sale of other real estate owned	(435)	(1,141)
Fair value	$ 3,791	$ 3,263

	Six months ended June 30, 2012	Six months ended June 30, 2011
Carrying value of other real estate owned prior to re-measurement	$ 4,643	$ 5,276
Write-downs included in gain (loss) on sale of other real estate owned	(536)	(1,250)
Fair value	$ 4,107	$ 4,026

At June 30, 2012 and 2011, and December 31, 2011, other real estate owned totaled $7.0 million, $8.7 million and $9.2 million, respectively.

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.

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.

Cash and due from banks, federal funds sold, interest-bearing deposits and time deposits in banks and accrued interest receivable and payable are liquid in nature and considered Level 1 or 2 of the fair value hierarchy.

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 and are considered Levels 2 and 3 of the fair value hierarchy. Financial instrument liabilities with no stated maturities have an estimated fair value equal to both the amount payable on demand and the carrying value and are considered Level 1 of the fair value hierarchy.

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.

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The estimated fair values and carrying values of all financial instruments under current authoritative guidance at June 30, 2012 and December 31, 2011, were as follows (in thousands):

	June 30, 2012		December 31, 2011		
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value	Fair Value Hierarchy
Cash and due from banks	$ 122,534	$ 122,534	$ 146,239	$ 146,239	Level 1
Federal funds sold	10,100	10,100			Level 1
Interest-bearing deposits in banks	25,794	25,794	104,597	104,597	Level 1
Interest-bearing time deposits in banks	74,594	74,594	61,175	61,175	Level 2
Available-for-sale securities	1,961,908	1,961,908	1,841,389	1,841,389	Levels 1 and 2
Held-to-maturity securities	1,459	1,485	3,609	3,655	Level 2
Loans	1,883,545	1,893,641	1,752,229	1,757,732	Level 3
Accrued interest receivable	23,353	23,353	22,446	22,446	Level 2
Deposits with stated maturities	711,622	713,140	752,298	754,186	Level 2
Deposits with no stated maturities	2,680,558				