CADENCE FINANCIAL CORP
Form 10-Q
November 05, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from ______ to ______

Commission File Number: 1-15773

CADENCE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Mississippi	**64-0694775**
(State or other jurisdiction of incorporation or organization)	**(I. R. S. Employer Identification No.)**

301 East Main Street, P. O. Box 1187, Starkville, Mississippi	**39760**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (662) 323-1341

(Former name, former address and former fiscal year, if changed since last report): N/A

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 Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. 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	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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:

Common Stock, $1 Par Value 11,912,564 shares as of September 30, 2009.

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PART I FINANCIAL INFORMATION

CADENCE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

(Unaudited)

(In thousands, except per share data)	2009	2008
INTEREST INCOME		
Interest and fees on loans	$ 47,639	$ 63,095
Interest and dividends on securities	14,333	15,716
Other interest income	273	335
Total interest income	62,245	79,146
INTEREST EXPENSE		
Interest on deposits	21,690	28,091
Interest on borrowed funds	5,993	9,047
Total interest expense	27,683	37,138
Net interest income	34,562	42,008
Provision for loan losses	76,460	18,003
Net interest income (loss) after provision for loan losses	(41,898)	24,005
OTHER INCOME		
Service charges on deposit accounts	6,349	6,791
Trust Department income	1,500	1,684
Mortgage loan fees	879	983
Other income	4,017	3,825
Securities gains, net	1,062	220
Total other income	13,807	13,503
OTHER EXPENSE		
Salaries and employee benefits	20,984	20,833
Premises and fixed asset expense	5,682	5,699
Impairment loss on goodwill	66,542	
Other expense	19,637	14,736
Total other expense	112,845	41,268
Income (loss) from continuing operations, before income taxes	(140,936)	(3,760)
Income tax expense (benefit)	(30,053)	(2,780)

Net income (loss) from continuing operations	(110,883)	(980)
Income from discontinued operations, before income taxes	649	551
Income tax expense	364	211
Net income from discontinued operations	285	340
Net income (loss)	(110,598)	(640)
Preferred stock dividend and accretion of discount	1,626	
Net income (loss) applicable to common shareholders	$ (112,224)	$ (640)
Net (income) loss per share from continuing operations - basic and diluted	$ (9.31)	$ (0.08)
Net income per share from discontinued operations - basic and diluted	$ 0.02	$ 0.03
Net income (loss) per share - basic and diluted	$ (9.28)	$ (0.05)
Net income (loss) applicable to common shareholders per share - basic and diluted	$ (9.42)	$ (0.05)
Dividends per common share	$ 0.05	$ 0.55

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CADENCE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

(Unaudited)

(In thousands, except per share data)	2009	2008
INTEREST INCOME		
Interest and fees on loans	$ 15,464	$ 19,592
Interest and dividends on securities	4,608	5,140
Other interest income	98	134
Total interest income	20,170	24,866
INTEREST EXPENSE		
Interest on deposits	6,817	8,642
Interest on borrowed funds	1,760	2,718
Total interest expense	8,577	11,360
Net interest income	11,593	13,506
Provision for loan losses	20,704	11,703
Net interest income (loss) after provision for loan losses	(9,111)	1,803
OTHER INCOME		
Service charges on deposit accounts	2,219	2,453
Trust Department income	527	542
Mortgage loan fees	242	275
Other income	1,269	1,465
Securities gains, net	923	65
Total other income	5,180	4,800
OTHER EXPENSE		
Salaries and employee benefits	6,902	6,829
Premises and fixed asset expense	1,910	1,896
Other expense	8,558	7,281
Total other expense	17,370	16,006
Income (loss) from continuing operations, before income taxes	(21,301)	(9,403)
Income tax expense (benefit)	(8,475)	(3,980)
Net income (loss) from continuing operations	(12,826)	(5,423)

Income from discontinued operations, before income taxes	646	233
Income tax expense	247	89
Net income from discontinued operations	399	144
Net income (loss)	(12,427)	(5,279)
Preferred stock dividend and accretion of discount	652	
Net income (loss) applicable to common shareholders	$ (13,079)	$ (5,279)
Net income (loss) per share from continuing operations - basic	$ (1.08)	$ (0.46)
Net income (loss) per share from continuing operations - diluted	$ (1.08)	$ (0.45)
Net income per share from discontinued operations - basic and diluted	$ 0.03	$ 0.01
Net income (loss) per share - basic and diluted	$ (1.04)	$ (0.44)
Net income (loss) applicable to common shareholders per share - basic and diluted	$ (1.10)	$ (0.44)
Dividends per common share	$	$ 0.05

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CADENCE FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)	Sept. 30, 2009 (Unaudited)	Dec. 31, 2008
ASSETS		
Cash and due from banks	$ 17,483	$ 37,207
Interest-bearing deposits with banks	37,442	14,403
Federal funds sold and securities purchased under agreements to resell	30,312	9,623
Total cash and cash equivalents	85,237	61,233
Securities available-for-sale	403,396	398,702
Securities held-to-maturity (estimated fair value of $2,773 at September 30, 2009 and $22,115 at December 31, 2008)	2,673	21,358
Other securities	14,249	16,369
Total securities	420,318	436,429
Loans	1,179,741	1,328,329
Less: allowance for loan losses	(44,939)	(20,730)
Net loans	1,134,802	1,307,599
Interest receivable	8,111	9,714
Premises and equipment, net	31,866	33,409
Goodwill and other intangible assets	1,518	68,849
Other assets	85,847	62,036
Total Assets	$ 1,767,699	$ 1,979,269
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Noninterest-bearing deposits	$ 168,264	$ 181,191
Interest-bearing deposits	1,243,180	1,279,968
Total deposits	1,411,444	1,461,159
Interest payable	1,869	2,892
Federal funds purchased and securities sold under agreements to repurchase	88,791	98,527
Subordinated debentures	30,928	30,928
Other borrowed funds	101,709	188,938
Other liabilities	12,148	11,260
Total liabilities	1,646,889	1,793,704
Shareholders Equity:		
Preferred stock $10 par value, authorized 10,000,000 shares as of September 30, 2009; issued 44,000 shares as of September 30, 2009	41,995	
Common stock $1 par value, authorized 50,000,000 shares as of September 30, 2009 and December 31, 2008; issued 11,912,564 shares as of September 30, 2009 and 11,914,814 shares as of December 31, 2008	11,913	11,915
Surplus	95,883	93,438
Retained earnings (accumulated deficit)	(32,844)	79,975
Accumulated other comprehensive income (loss)	3,863	237

Total shareholders equity	120,810	185,565
Total Liabilities and Shareholders Equity	$ 1,767,699	$ 1,979,269

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CADENCE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

(Unaudited)

(In thousands)	**2009**	**2008**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (110,598)	$ (640)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,628	2,912
Deferred income taxes	(25,312)	(6)
Provision for loan losses	76,460	18,003
Net performance share activity	81	476
Gain on sale of securities, net	(1,062)	(225)
Impairment loss on goodwill	66,542	
Gain on sale of GCM Insurance assets	(502)	
(Increase) decrease in interest receivable	1,603	3,224
(Increase) decrease in loans held for sale	1,839	205
(Increase) decrease in other assets	(326)	(11,510)
Increase (decrease) in interest payable	(1,023)	(1,765)
Increase (decrease) in other liabilities	1,462	2,198
Net cash provided by (used in) operating activities	11,792	12,872
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and calls of securities	426,413	166,580
Proceeds from sale of securities	114,562	20,958
Purchase of securities	(518,992)	(180,638)
Net cash proceeds from sale of GCM Insurance assets	417	
(Increase) decrease in loans	94,498	(26,852)
(Additions) disposals of premises and equipment	(43)	(139)
Net cash provided by (used in) investing activities	116,855	(20,091)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in deposits	(49,715)	19,312
Issuance of preferred stock and warrants	44,000	
Dividend paid on preferred stock	(1,320)	
Dividend paid on common stock	(595)	(6,549)
Net change in federal funds purchased and securities sold under agreements to repurchase	(9,736)	3,995
Net change in short-term FHLB borrowings	(20,000)	(115,972)
Proceeds from long-term debt	35,000	125,000
Repayment of long-term debt	(102,277)	(23,725)
Net cash provided by (used in) financing activities	(104,643)	2,061
Net increase (decrease) in cash and cash equivalents	24,004	(5,158)
Cash and cash equivalents at beginning of period	61,233	52,397
Cash and cash equivalents at end of period	$ 85,237	$ 47,239

Cash paid during the period for:

Interest	$ 28,706	$ 38,903
Income tax	$	$ 2,554

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CADENCE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements include the accounts of Cadence Financial Corporation (the Corporation), Cadence Bank, N.A. (Cadence or the Bank), a wholly-owned subsidiary of the Corporation, Enterprise Bancshares, Inc. (Enterprise), a wholly-owned subsidiary of the Corporation, Galloway-Chandler-McKinney Insurance Agency, Inc. (GCM Insurance), a wholly-owned subsidiary of Cadence, NBC Insurance Services of Alabama, Inc., a wholly-owned subsidiary of Cadence, NBC Service Corporation (NBC Service), a wholly-owned subsidiary of Cadence, and Commerce National Insurance Company (CNIC), a wholly-owned subsidiary of NBC Service. All significant intercompany accounts and transactions have been eliminated. On August 31, 2009, the Bank completed the disposition of the assets used in and liabilities arising from GCM Insurance s operations. See Note 11 for additional information relating to this transaction.

In the process of preparing these financial statements, management makes certain estimates and assumptions that affect the reported amounts that appear in these statements. Management believes that such estimates and assumptions are reasonable and are based on the best information available; however, actual results could differ. The results of operations in the interim statements are not necessarily indicative of results that may be expected for the full year.

In the opinion of management, all adjustments necessary for the fair presentation of the financial statements presented in this report have been made. Such adjustments were of a normal recurring nature unless otherwise disclosed in this Form 10-Q.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Corporation s annual report on Form 10-K for the year ended December 31, 2008.

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 855, Subsequent Events, requires companies to disclose the date through which subsequent events have been evaluated by management. The Corporation s management has evaluated the effect of subsequent events on these financial statements through November 5, 2009, the date the financial statements were available to be issued.

Note 1. Recently Issued Accounting Pronouncements

ASC 715-20-65-2 (formerly FSP No. FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets , issued in December 2008), requires companies to disclose additional information about their postretirement benefit plan assets, including investment policies and strategies, categories of plan assets, fair value measurements of plan assets, and significant concentrations of risk. The additional disclosure requirements are effective for fiscal years ending after December 15, 2009, with earlier application permitted. The Corporation is currently determining the effects of this guidance on its financial statement disclosures.

In June 2009, the FASB issued ASC 105-10 (formerly FASB Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles). Upon its effective date, ASC 105-10 became the single source of generally accepted accounting principles for nongovernmental entities. ASC 105-10 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Corporation adopted this guidance for the three and nine month periods ending September 30, 2009. The adoption did not significantly impact the Corporation s consolidated financial statements and related disclosures.

Note 2. Goodwill and Other Intangible Assets

Goodwill represents the cost of acquired institutions in excess of the fair value of the net assets acquired. In accordance with ASC 350, Intangibles-Goodwill and Other, the Corporation s goodwill was not amortized but was periodically tested for impairment. The Corporation s annual test of goodwill impairment was last performed as of September 30, 2008.

ASC 350 also requires that goodwill be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Several events occurred during the first quarter of 2009 that triggered an additional test of goodwill for impairment, and the Corporation engaged a third party to perform this test. The test concluded that the Corporation s goodwill was fully impaired as of March 31, 2009. As a result, a goodwill impairment charge of $66.8 million ($304,000 of which related to GCM Insurance) was recognized as of that date, and the charge eliminated all goodwill previously reflected on the Corporation s balance sheet. Thus, no annual test of goodwill impairment was required as of September 30, 2009.

Other identifiable intangible assets consist primarily of the core deposit premiums arising from acquisitions. The core deposit premiums were established using the discounted cash flow approach and are being amortized using an accelerated method over the estimated remaining life of the acquired core deposits.

Note 3. Performance Shares and Stock Options

The Corporation accounts for stock options in accordance with ASC 718, Compensation-Stock Compensation. This guidance requires that the fair value of equity instruments exchanged for employee services (as determined on the grant date of the award) be recognized as compensation cost over the period during which an employee is required to provide service in exchange for the award the requisite service period (usually the vesting period). Changes in fair value during the requisite service period are recognized as compensation cost over that period.

In 2006, the Corporation s shareholders adopted a new Long-Term Incentive Compensation Plan. This plan gave the Compensation Committee of the Board of Directors additional alternatives for using share-based compensation. In 2007 and 2008, under the provisions of the Long-Term Incentive Compensation Plan, the Compensation Committee awarded performance shares of stock to certain eligible employees. The shares vest in equal amounts over a four-year period after they are earned.

As of September 30, 2009, a total of 42,382 performance shares are outstanding, all of which have been earned. For the three and nine months ended September 30, 2009, compensation expense relating to performance shares totaled $51,000 and $119,000, respectively. For the three and nine months ended September 30, 2008, compensation expense relating to performance shares totaled $68,000 and $186,000, respectively.

Note 4. Variable Interest Entities

Through a business trust subsidiary, the Corporation has issued $30.9 million in subordinated debentures that were used to support trust preferred securities. These debentures are the sole assets of the trust subsidiary. In accordance with ASC 810, Consolidation, the trust subsidiary is not consolidated into the financial statements of the Corporation.

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Note 5. Comprehensive Income

The following tables disclose comprehensive income for the periods reported in the Consolidated Statements of Income:

(In thousands)	Nine Months Ended September 30, 2009	2008
Net income (loss)	$ (110,598)	$ (640)
Net change in other comprehensive income (loss), net of tax:		
Realized (gains) losses included in net income (loss)	(656)	(139)
Unrealized gains (losses) on securities	4,282	(973)
Unrealized gains (losses) on interest rate swaps		44
Net change in other comprehensive income (loss), net of tax	3,626	(1,068)
Comprehensive income (loss)	$ (106,972)	$ (1,708)
Accumulated other comprehensive income (loss) at beginning of period	$ 237	$ (1,625)
Net change in other comprehensive income (loss)	3,626	(1,068)
Accumulated other comprehensive income (loss) at end of period	$ 3,863	$ (2,693)

(In thousands)	Three Months Ended September 30, 2009	2008
Net income (loss)	$ (12,427)	$ (5,279)
Net change in other comprehensive income (loss), net of tax:		
Realized (gains) losses included in net income (loss)	(570)	(43)
Unrealized gains (losses) on securities	4,812	2,100
Unrealized gains (losses) on interest rate swaps		57
Net change in other comprehensive income (loss), net of tax	4,242	2,114
Comprehensive income (loss)	$ (8,185)	$ (3,165)
Accumulated other comprehensive income (loss) at beginning of period	$ (379)	$ (4,807)
Net change in other comprehensive income (loss)	4,242	2,114
Accumulated other comprehensive income (loss) at end of period	$ 3,863	$ (2,693)

Note 6. Defined Benefit Pension Plan

The following tables contain the components of the net periodic benefit cost of the Corporation s defined benefit pension plan for the periods indicated:

(In thousands)	**Nine Months Ended September 30, 2009**	**2008**
Service cost	$ 550	$ 643
Interest cost	564	525
Expected return on assets	(685)	(590)
Net (gain)/loss recognition	260	221
Prior service cost amortization	(68)	(70)
Preliminary net periodic benefit cost	621	729
Immediate recognition due to settlement and curtailment	740	
Net periodic benefit cost	$ 1,361	$ 729

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(In thousands)	Three Months Ended September 30, 2009	2008
Service cost	$ 178	$ 177
Interest cost	186	151
Expected return on assets	(225)	(180)
Net (gain)/loss recognition	84	55
Prior service cost amortization	(22)	(24)
Preliminary net periodic benefit cost	201	179
Immediate recognition due to settlement and curtailment	290	
Net periodic benefit cost	$ 491	$ 179

The expected rates of return for 2009 and 2008 were 7.0% and 7.5%, respectively.

Note 7. Investment Securities

In accordance with ASC 320, Investments Debt and Equity Securities, for the three and nine month period ended September 30, 2009, management reviewed the securities portfolio for securities that had unrealized losses for more than twelve months that could be considered other-than-temporary. As of September 30, 2009, approximately 2% of the number of securities in the portfolio reflected an unrealized loss.

In conducting its review for other-than-temporary impairment, management evaluated a number of factors including, but not limited to the following: the amount of the unrealized loss; the length of time in which the unrealized loss has existed; the financial condition of the issuer; rating agency changes on the issuer; and management s intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. Based on this review, management does not believe any individual security with an unrealized loss as of September 30, 2009, is other-than-temporarily impaired.

Note 8. Derivative Instruments

In 2008 and 2009, the Corporation hedged a portion of its floating rate prime based lending portfolio by entering into floating to fixed interest rate swaps. These transactions were cash flow hedges as defined by ASC 815, Derivatives and Hedging, and they were accounted for under that guidance. As of September 30, 2009, the Corporation had no outstanding swaps.

For the three and nine month periods ended September 30, 2008, $57,000 and $44,000 in unrealized gains (net of tax), respectively, were recorded as adjustments to accumulated other comprehensive income (loss) for the change in fair value of the Corporation s outstanding swaps.

Note 9. Fair Value

The following disclosure of the estimated fair value of financial instruments is made in accordance with ASC 825, Financial Instruments. The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized 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.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents For such short-term instruments, the carrying amount is a reasonable estimate of fair value.

Securities For securities held as investments, fair value equals market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities; however, as of September 30, 2009, quoted market prices were available for all securities. The fair value of other securities, which consist of FHLB stock and Federal Reserve Bank stock, is estimated to be the carrying value, which is par.

Loans The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits The fair values of demand deposits are, as required by ASC 825, equal to the carrying value of such deposits. Demand deposits include noninterest-bearing demand deposits, savings accounts, NOW accounts, and money market demand accounts. The fair value of variable rate term deposits, those repricing within six months or less, approximates the carrying value of these deposits. Discounted cash flows have been used to value fixed rate term deposits and variable rate term deposits repricing after six months. The discount rate used is based on interest rates currently being offered on comparable deposits as to amount and term.

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase The fair value of any federal funds purchased, securities sold under agreements to repurchase and other short-term borrowings generally approximates their carrying value. The fair value of structured repurchase agreements is estimated using discounted cash flows, based on current incremental borrowing rates for similar types of arrangements.

Subordinated Debentures The subordinated debentures bear interest at a variable rate and the carrying value approximates the fair value.

FHLB and Other Borrowings The fair value of the fixed rate borrowings is estimated using discounted cash flows, based on current incremental borrowing rates for similar types of borrowing arrangements. The carrying amount of any variable rate borrowings approximates their fair values.

Off-Balance Sheet Instruments Fair values of off-balance sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value until such commitments are funded or closed. Management has determined that these instruments do not have a distinguishable fair value and no fair value has been assigned.

	September 30, 2009		**December 31, 2008**	
(In thousands)	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial Instruments:				
Assets:				
Cash and cash equivalents	$ 85,237	$ 85,237	$ 61,233	$ 61,233
Securities available-for-sale	403,396	403,396	398,702	398,702
Securities held-to-maturity	2,673	2,773	21,358	22,115
Other securities	14,249	14,249	16,369	16,369
Loans	1,134,802	1,138,019	1,307,599	1,305,410
Liabilities:				
Noninterest-bearing deposits	168,264	168,264	181,191	181,191
Interest-bearing deposits	1,243,180	1,230,414	1,279,968	1,285,294
Federal funds purchased and securities sold under agreements to repurchase	88,791	91,413	98,527	101,427
Subordinated debentures	30,928	30,928	30,928	30,928
FHLB and other borrowings	101,709	99,369	188,938	192,491

ASC 820, Fair Value Measurements and Disclosures, provides guidance for using fair value to measure assets and liabilities and establishes a hierarchy to prioritize the inputs used to measure fair value. The fair value hierarchy gives the highest priority to a valuation based on quoted prices in active markets for identical assets and liabilities (Level 1), moderate priority to a valuation based on quoted prices in active markets for similar assets and

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liabilities and/or based on assumptions that are observable in the market (Level 2), and the lowest priority to a valuation based on assumptions that are not observable in the market (Level 3).

In accordance with the disclosure requirements of ASC 820, the following table reflects assets measured at fair value on a recurring basis. Fair value for these assets was determined by reference to quoted market prices in active markets for identical assets (Level 1 inputs).

(In thousands)	Fair Value at September 30, 2009
Available-for-sale securities	$ 403,396

The following valuation methodologies are used for assets measured at fair value on a non-recurring basis and recognized in the Corporation s consolidated balance sheets, as well as the general classification of these assets within the valuation hierarchy.

Impaired Loans A loan is considered impaired when, based on current information, it is probable that the Corporation will not receive all amounts due in accordance with the contractual terms of the loan agreement. Once a loan has been identified as impaired, management measures impairment in accordance with ASC 310, Receivables. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan s effective interest rate or the loan s observable market price, or based on the fair value of the collateral if the loan is collateral-dependent. When management s measured value of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve within the allowance for loan losses. Any subsequent measurement adjustments are recorded as adjustments to the allowance for loan losses. Impaired loans are classified within Level 3 of the fair value hierarchy.

Other Real Estate Owned Other real estate owned (OREO) consists of properties acquired through foreclosure and, as held for sale property, is recorded at the lower of the outstanding loan balance or current appraisal less estimated costs to sell. Any write-down to fair value required at the time of foreclosure is charged to the allowance for loan losses. Subsequent gains or losses on other real estate resulting from the sale of the property or additional valuation allowances required due to further declines in market value are reported in other noninterest income or expenses. OREO is classified within Level 3 of the fair value hierarchy.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis. Fair value for these assets was determined based on the methodology discussed above, using assumptions that are not observable in the market (Level 3 inputs).

(In thousands)	Fair Value at September 30, 2009
Impaired loans	$ 60,824
Other real estate owned	14,760

ASC 825, Financial Instruments, allows entities the option, at specified election dates, to measure financial assets and financial liabilities at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, ASC 825 specifies that all subsequent changes in fair value for that instrument must be reported in earnings.

As of September 30, 2009, the Corporation s balance sheet did not include any financial assets or liabilities for which the fair value option of ASC 825 was elected.

Note 10. Preferred Stock

On January 9, 2009, the Corporation completed the sale of $44 million of non-voting preferred stock to the U.S. Treasury Department under the Capital Purchase Program (CPP). These senior preferred shares pay a cumulative annual dividend at a 5% rate for the first five years and will reset to a rate of 9% after five years if not redeemed by the Corporation prior to that time. In connection with the issuance of the senior preferred shares, the Corporation also issued to the U.S. Treasury a warrant to purchase the Corporation s common stock up to a maximum of 15% of the senior preferred amount, or $6.6 million.

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Note 11. Discontinued Operations

On August 31, 2009, the Bank completed the disposition of the assets used in and liabilities arising from GCM Insurance s operations to four limited liability companies established by former owners and employees of GCM Insurance. The total purchase price of the assets sold, net of liabilities assumed, was approximately $5.5 million.

As a result of this transaction, the consolidated statements of income have been restated for all periods to reflect GCM Insurance s operations as discontinued operations. The net income from discontinued operations for the quarter and nine months ended September 30, 2009, includes a gain on sale of approximately $502,000. This gain is subject to adjustment in the fourth quarter of 2009 based on final settlements related to pension and tax costs at year-end.

Summarized financial information for discontinued operations is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2009**	**2008**	**2009**	**2008**
Income	$ 1,044	$ 1,460	$ 3,449	$ 3,937
Expense	900	1,227	3,302	3,386
Income from discontinued operations	144	233	147	551
Gain on sale	502		502	
Income tax expense	247	89	364	211
Net income from discontinued operations	$ 399	$ 144	$ 285	$ 340

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

Forward-Looking Information

The following provides a narrative discussion and analysis of significant changes in our results of operations and financial condition for the three and nine months ended September 30, 2009. Certain information included in this discussion contains forward-looking statements and information that are based on management s beliefs, expectations and conclusions, drawn from certain assumptions and information currently available. The Private Securities Litigation Act of 1995 encourages the disclosure of forward-looking information by management by providing a safe harbor for such information. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although we believe that the expectations and conclusions reflected in such forward-looking statements are reasonable, such forward-looking statements are based on numerous assumptions (some of which may prove to be incorrect) and are subject to risks and uncertainties, which could cause the actual results to differ materially from our expectations. When used in this discussion, the words anticipate, believe, estimate, expect, objective, project, forecast, goal expressions are intended to identify forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, factors that could cause our actual results to differ materially from those contemplated in any forward-looking statements include, among others, increased competition, regulatory factors, economic conditions, changing interest rates, changing market conditions (including specifically the downturn in the U. S. real estate market), availability or cost of capital, changes in accounting standards and practices, employee workforce factors, ability to achieve cost savings and enhance revenues, the assimilation of acquired operations and establishing credit practices and efficiencies therein, acts of war or acts of terrorism or geopolitical instability and other effects of legal and administrative proceedings, changes in federal, state or local laws and regulations and other factors identified in Item 1A, Risk Factors, and Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of our Annual Report on Form 10-K for the year ended December 31, 2008, and that may be discussed from time to time in other reports filed with the Securities and Exchange Commission subsequent to this report. Readers are cautioned not to place undue reliance on any forward-looking statements made by or on behalf of the Corporation. Any such statement speaks only as of the date the statement was made. We undertake no obligation to update or revise any forward-looking statements, whether as a result of changes in actual results, changes in assumptions or other factors affecting such statements.

For purposes of the following discussion and analysis of the Corporation s financial condition and results of operations, the words the Corporation, we, us and our refer to the combined entities of Cadence Financial Corporation and Cadence, unless the context suggests otherwis

Introduction and Management Overview

The Corporation is a bank holding company that owns Cadence. Cadence operates in the states of Mississippi, Alabama, Tennessee, Florida and Georgia. Cadence s primary business is providing traditional commercial and retail banking services to customers. Cadence also provides other financial services, including trust services, mortgage services and investment products. Our stock is traded on The NASDAQ Global Select Market (NASDAQ) under the ticker symbol of CADE .

Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

Summary of Nine Months Ended September 30, 2009

Participation in Capital Purchase Program. In January 2009, we sold 44,000 shares of non-voting Series A preferred stock, for an aggregate purchase price of $44.0 million and issued a warrant to purchase up to 1,145,833 shares of our common stock to the U.S. Treasury under the Capital Purchase Program (CPP).

Net Interest Income. Our net interest income declined from $42.1 million in the first nine months of 2008 to $34.6 million in the first nine months of 2009. For the first nine months of 2009, our net interest margin was 2.47%, compared to 3.10% for the first nine months of 2008. Our loan yields declined by 121 basis points as compared to the first nine months of 2008, partly due to the 175 basis point reduction in interest rates between September 30, 2008 and September 30, 2009. Our yield on earning assets declined by 139 basis points during this period, but was offset somewhat by a 3.3% increase in average earning assets.

Provision for Loan Losses. Our provision for loan losses was $76.5 million for the first nine months of 2009, as compared to $18.0 million for the first nine months of 2008. We incurred $52.3 million in net charge-offs for the first nine months of 2009, compared to $14.8 million for the first nine months of 2008. Also, we significantly increased our allowance for loan losses during the nine months of 2009. Our allowance for loan losses was $44.9 million at September 30, 2009, compared with our allowance for loan losses at December 31, 2008 of $20.7 million. We have experienced an increase in non-performing loans, mostly due to real estate construction and development loans. During the first nine months of 2009, we noted increased weakness in our Middle Tennessee market.

Other Income (Noninterest Income). Our noninterest income, exclusive of securities gains and losses, declined by $538,000, or 4.1%, between the first nine months of 2008 and the first nine months of 2009.

Other Expense (Noninterest Expense). During the first nine months of 2009, total noninterest expenses increased by $71.6 million from the same period of 2008. Included in this increase is a $66.5 million impairment loss on goodwill. The remaining $5.1 million increase resulted primarily from increases in FDIC insurance premiums, a loss on early extinguishment of debt, and expenses associated with our efforts to raise capital that were suspended during the third quarter.

Net Income/(Loss). For the first nine months of 2009, we reported a net loss applicable to common shareholders of $112.2 million, or $(9.42) per common share, compared to a net loss of $640,000, or $(0.05) per common share, for the first nine months of 2008.

Loan Portfolio. As of September 30, 2009, our loan portfolio was $1.180 billion, distributed among commercial real estate loans, commercial and industrial loans, 1-4 family mortgages and consumer loans. As of September 30, 2009, our loan portfolio was composed of approximately 60.0% variable rate loans and 40.0% fixed rate loans. Beginning in the third quarter of 2008, we made a concerted effort to reduce our concentration in commercial real estate loans, particularly residential construction and development loans, which typically have higher yields but also higher risk. Overall, our average loan balances declined by approximately $83.9 million, or 6.2%, from the first nine months of 2008 to the first nine months of 2009, from $1.353 billion for the first nine months of 2008 to $1.269 billion for the first nine months of 2009.

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Investment Portfolio. The average balance of our investment portfolio was $448.4 million for the first nine months of 2009, compared to $437.0 million for the first nine months of 2008, representing an increase of $11.4 million, or 2.6%. However, our yield on securities declined by 53 basis points to 4.27% over this same period.

Federal Funds Sold and Other Interest-Bearing Assets. Our average balances in federal funds sold and other interest-bearing assets increased significantly from the first nine months of 2008 to the first nine months of 2009, from $24.3 million to $157.2 million. This variance resulted from our intentionally building liquidity by accumulating deposits and investing in short-term assets. Our yields on these assets declined from 1.84% for the first nine months of 2008 to 0.23% for the first nine months of 2009, which negatively affected our overall yield on earning assets.

Deposits. Our overall cost of funds declined by 63 basis points between the first nine months of 2008 and the first nine months of 2009. Average interest-bearing deposits increased 9.6% to $1.356 billion for the first nine months of 2009, compared to $1.238 billion for the first nine months of 2008, somewhat offset by a decline of $81.6 million, or 23.8%, in average borrowed funds.

During the first quarter of 2009, we accumulated an additional $166 million in deposits. During the third quarter of 2009, we used a portion of those funds to repay Federal Home Loan Bank (FHLB) borrowings. The remaining funds were held at September 30, 2009 in our Federal Reserve account and in short-term U.S. Treasury obligations.

Summary of Quarter Ended September 30, 2009

Sale of Assets & Liabilities of Galloway-Chandler-McKinney Insurance Agency, Inc. (GCM Insurance). On August 31, 2009, we completed the disposition of the assets used in and liabilities arising from GCM Insurance s operations to four limited liability companies established by former owners and employees of GCM Insurance. The total purchase price of the assets sold, net of liabilities assumed, was approximately $5.5 million. For the quarter ended September 30, 2009, we recognized a gain of $502,000 related to this transaction. The gain is subject to adjustment in the fourth quarter of 2009 based on final settlements related to pension and tax costs at year-end.

Net Interest Income. Net interest income for the third quarter of 2009 was $11.6 million, compared to $13.5 million for the same quarter of 2008, a decrease of 14.4%. During the third quarter of 2009, the net interest margin was 2.56%, compared to 3.00% for the same period of 2008. This 44 basis point decrease in margin resulted primarily from our intentionally building liquidity by accumulating deposits and investing in short-term assets with lower yields and the fact that we were not able to decrease our cost of funding at the same rate that our yields declined on loans and investment securities. When comparing the third quarter of 2009 to the same quarter of 2008, we lost 98 basis points of yield on our earning assets but only reduced the cost of funds by 66 basis points. Our average earning assets declined by $22.0 million, or 1.2% between the third quarter of 2008 and the third quarter of 2009.

Provision for Loan Losses. The provision for loan losses increased from $11.7 million during the third quarter of 2008 to $20.7 million in the third quarter of 2009. This increase was due to higher net charge-offs ($22.5 million in the third quarter of 2009 as compared to $9.4 million in the third quarter of 2008), as well as an increase in non-performing loans between the third quarter of 2008 and the third quarter of 2009. The increase in net charge-offs occurred primarily within our construction and land development portfolio, and the increase in non-performing loans was primarily due to the economy s impact on real estate-based loans.

Other Income (Noninterest Income). Our noninterest income, exclusive of securities gains and losses, declined by $478,000, or 10.1%, from the third quarter of 2008 to the third quarter of 2009.

Other Expense (Noninterest Expense). Noninterest expenses increased by $1.4 million, or 8.5%, during the third quarter of 2009, compared with the third quarter of 2008. This increase resulted primarily from increases in FDIC insurance premiums, a loss on early extinguishment of debt, and expenses associated with our efforts to raise capital that were suspended during the third quarter. These increases were partially offset by a reduction in our expenses relating to other real estate owned (OREO).

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Net Income/(Loss). For the third quarter of 2009, we reported a net loss applicable to common shareholders of $13.1 million, or $(1.10) per common share, compared to a net loss of $5.3 million, or $(0.44) per common share, for the third quarter of 2008.

Loan Portfolio. Our average loan balances declined by approximately $131.8 million, or 9.7%, to $1.221 billion for the third quarter of 2009, compared to $1.353 billion for the third quarter of 2008.

Investment Portfolio. The average balance of our investment portfolio was $436.0 million for the third quarter of 2009, compared to $432.4 million for the third quarter of 2008, representing an increase of $3.7 million, or 0.8%. Our yield on securities declined by 54 basis points to 4.19% over this same period.

Federal Funds Sold and Other Interest-Bearing Assets. Our average balances in federal funds sold and other interest-bearing assets increased significantly from the third quarter of 2008 to the third quarter of 2009, from $32.1 million to $138.3 million. This variance resulted from our intentionally building liquidity by accumulating deposits and investing in short-term assets. Our yields on these assets declined from 1.66% for the third quarter of 2008 to 0.28% for the third quarter of 2009, which negatively affected our overall yield on earning assets.

Deposits. Our overall cost of funds declined by 66 basis points between the third quarter of 2008 and the third quarter of 2009. Average interest-bearing deposits increased 4.0% to $1.313 billion for the third quarter of 2009, compared to $1.263 billion for the third quarter of 2008, somewhat offset by a decline of $96.4 million, or 29.6%, in average borrowed funds.

Outlook for Remainder of 2009

We believe our most significant challenge for the remainder of 2009 will be managing credit quality. We have taken an aggressive stance in addressing credit issues in our loan portfolio to minimize future risks, including taking an increased focus on underwriting standards and updating our loan policies. We have a special assets team in place to manage workout situations and assist in the timely disposition of defaulted assets. Our management information systems relating to loan concentrations provide us with current and detailed information about the status of the loans in our portfolio. Although we believe that these steps enhance our ability to manage credit quality, credit quality will remain an issue as long as current economic trends, including increasing unemployment rates and declining real estate prices, continue.

We continue to look for ways to grow noninterest income; however, the growth of noninterest income will remain a challenge under current economic conditions. We will also continue our efforts to control noninterest expenses. We expect our costs for FDIC insurance premiums to remain high for 2009, and we expect additional increases in OREO expenses based on recent additions. If rates remain flat as we currently expect, it will be difficult for us to expand our margin significantly. However, we also expect our deposits and wholesale funding balances to continue to decline, as we are using our excess liquidity to absorb higher-cost maturing liabilities to reduce interest expense, which should add some improvement to our margin.

Critical Accounting Policies

Our accounting and financial reporting policies conform to United States generally accepted accounting principles and to general practices within the banking industry. Note A of the Notes to Consolidated Financial Statements in our annual report contains a summary of our accounting policies. Management is of the opinion that Note A, read in conjunction with all other information in our annual report on Form 10-K for the year ended December 31, 2008, and the information in this quarterly report, including this Management s Discussion and Analysis, should be sufficient to provide the reader with the information needed to understand our financial condition and results of operations.

Critical Accounting Policies. We believe that the areas of the financial statements that require the most difficult, subjective and complex judgments, and therefore contain the most critical accounting estimates, are as follows:

- the provision for loan losses and the resulting allowance for loan losses;

- the liability and expense relating to our pension and other postretirement benefit plans;

issues relating to other-than-temporary impairment losses in the investment portfolio;

goodwill and other intangible assets; and

income taxes.

Provision/Allowance for Loan Losses. Our allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. The allowance for loan losses is maintained at a level that we believe is adequate to absorb all probable losses on loans inherent in the loan portfolio as of the reporting date. Events that are not within our control, such as changes in economic factors, could change subsequent to the reporting date and could cause our allowance for loan losses to be over or understated. The amount of the allowance is affected by loan charge-offs, which decrease the allowance; recoveries on loans previously charged off, which increase the allowance; and the provision for loan losses charged to earnings, which increases the allowance. In determining the provision for loan losses, we monitor fluctuations in the allowance resulting from actual charge-offs and recoveries and periodically review the size and composition of the loan portfolio in light of current and anticipated economic conditions. If actual losses exceed the amount of the allowance for loan losses, our earnings could be adversely affected.

The allowance for loan losses represents management s estimate of the amount necessary to provide for losses inherent in the loan portfolio in the normal course of business. Due to the uncertainty of risks in the loan portfolio, management s judgment of the amount of the allowance necessary to absorb loan losses is approximate. The allowance for loan losses is also subject to regulatory examinations and determination by the regulatory agencies as to its adequacy.

The allowance for loan losses is comprised of the following three components: specific reserves, general reserves and unallocated reserves. Generally, all loans that are identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. A loan is considered impaired when, based on current information, it is probable that we will not receive all amounts due in accordance with the contractual terms of the loan agreement. Once a loan has been identified as impaired, management measures impairment in accordance with ASC 310, Receivables. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan s effective interest rate or the loan s observable market price, or based on the fair value of the collateral if the loan is collateral-dependent. When management s measured value of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve. These specific reserves are determined on an individual loan basis based on our current evaluation of our loss exposure for each credit, given the payment status, financial condition of the borrower and value of any underlying collateral. Loans for which specific reserves are provided are excluded from the general reserve and unallocated reserve calculations described below. Changes in specific reserves from period to period are the result in changes in the circumstances of individual loans such as charge-offs, pay-offs, changes in collateral values or other factors.

We also maintain a general reserve for each loan type in the loan portfolio. Within each loan type, the portfolio is further segmented by risk ratings and by delinquency status. In determining the amount of the general reserve portion of our allowance for loan losses, we consider factors such as our historical loan loss experience, the growth, composition and diversification of our loan portfolio, current delinquency levels, adverse situations that may affect the borrower s ability to repay, estimated value of the underlying collateral, the results of recent regulatory examinations and general economic conditions. Through the second quarter of 2009, general reserves for these loans were based upon three-year historical loss rates. Beginning in the third quarter of 2009, general reserves for these loans are based upon historical loss rates from the most recent twenty quarters, with the more recent quarters receiving the most weight. We use this information to set the general reserve portion of the allowance for loan losses at a level we deem prudent.

Because there are additional risks of losses that cannot be quantified precisely or attributed to particular loans or types of loans, including general economic and business conditions and credit quality trends, we have established an unallocated portion of the allowance for loan losses based on our evaluation of these risks. The unallocated portion of our allowance is determined based on various factors, including general economic conditions of our market area, the growth, composition and diversification of our loan portfolio, types of collateral securing our loans, the experience level of our lending officers and staff, the quality of our credit risk management and the results of independent third party reviews of our classification of credits. The unallocated portion of the allowance for loan losses was $3.1 million, or 6.8% of the total allowance, as of September 30, 2009, and $4.0 million, or 19.3% of the total allowance, as of December 31, 2008.

Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for loan losses to the Bank s executive committee and our full board of directors, indicating any change in the allowance for loan losses since the last review and any recommendations as to adjustments in the allowance for

loan losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as events change. The allowance for loan losses was $44.9 million as of September 30, 2009, compared to $20.7 million as of December 31, 2008. This increase reflects further deterioration in our loan portfolio, due primarily to the lack of demand for residential housing as well as an overall decline in the value of real estate, and the subsequent increase in net charge-offs.

Pension and Other Postretirement Benefit Plans. Another area that requires subjective and complex judgments is the liability and expense relating to our pension and other postretirement benefit plans. We maintain several benefit plans for our employees. They include a defined benefit pension plan, a defined contribution pension plan, a 401(k) plan and a deferred compensation plan. We make all contributions to these plans when they are due.

The defined benefit pension plan is the only plan that requires multiple assumptions to determine the liability under the plan. This plan has been frozen to new participants for several years. Management evaluates, reviews with the plan actuaries, and updates as appropriate the assumptions used in the determination of pension liability, including the discount rate, the expected rate of return on plan assets, and increases in future compensation. Actual experience that differs from the assumptions could have a significant effect on our financial position and results of operations. The discount rate and the expected rate of return on the plan assets have a significant impact on the actuarially computed present value of future benefits that is recorded on the financial statements as a liability and the corresponding pension expense.

In selecting the expected rate of return, management, in consultation with the plan trustees, selected a rate based on assumptions compared to recent returns and economic forecasts. We consider the current allocation of the portfolio and the probable rates of return of each investment type. In selecting the appropriate discount rate, management, with the assistance of actuarial consultants, performs an analysis of the plan s projected benefit cash flows against discount rates from a national Pension Discount Curve (a yield curve used to measure pension liabilities). Based on the analysis, management used a discount rate of 5.75% in 2006 and 2007 and a discount rate of 6.0% in 2008. We used an expected rate of return of 7.5% for 2006, 2007 and 2008. From a historical perspective, the rates of return on the plan were 11.0% for 2006, 7.2% for 2007, and (23.9%) for 2008. Additionally, our philosophy has been to fund the plan annually to the maximum amount deductible under the Internal Revenue Service (IRS) rules. As of December 31, 2008, the plan had a current accumulated benefit obligation of approximately $10.7 million, and plan assets with a fair value of approximately $10.7 million.

ASC 715, Compensation-Retirement Benefits, requires us to recognize the funded status of the plan (defined as the difference between the fair value of plan assets and the projected benefit obligation) on the balance sheet and to recognize in other comprehensive income any gains or losses and prior service costs or benefits not included as components of periodic benefit cost. Detailed information on our pension plan and the related impacts of these changes on the amounts recorded in our financial statements can be found in Note M (Employee Benefits) of the notes to consolidated financial statements in our December 31, 2008 Form 10-K (audited).

Other-Than-Temporary Impairment of Investment Securities. A third area that requires subjective and complex judgments on the part of management is the review of the investments in the investment portfolio for other-than-temporary impairments. ASC 320, Investments Debt and Equity Securities, requires us to review our investment portfolio and determine if it has impairment losses that are other-than-temporary. In making its determination, management considers the following items:

- the length of time and extent to which the current market value is less than cost;
- evidence of a forecasted recovery;
- financial condition and the industry environment of the issuer, including whether the issuer is a government or government-backed agency (all of the mortgage-backed securities and collateralized mortgage obligations in our portfolio are issued by government-backed agencies);
- downgrades of the securities by rating agencies;
- whether there has been a reduction or elimination of dividends or interest payments;

whether we have the intent or ability to hold the securities for a period of time sufficient to allow for anticipated recovery of fair value; and

interest rate trends that may impact recovery and realization.

As of September 30, 2009, our investment portfolio included certain securities that were impaired by definition, but based on our review and consideration of the criteria listed above, we determined that none of the impairments were other-than-temporary.

Goodwill and Other Intangible Assets. ASC 350, Intangibles Goodwill and Other, eliminated the requirement to amortize goodwill; however, it does require periodic testing for impairment using a two-step approach. The first step is to determine whether impairment could exist. If the results of the first step of testing indicate that impairment does not exist, the test is complete. If the results of the first step indicate that impairment could exist, the second step of testing must be performed. We completed our periodic impairment test in accordance with ASC 350 as of September 30, 2008. Based on the results of the first step of testing, we concluded that no impairment writedown was warranted as of September 30, 2008.

ASC 350 requires that goodwill be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Several events occurred during the first quarter of 2009 that we believed triggered an additional test of goodwill for impairment. These events included our results of operations for the three months ended March 31, 2009, the changes in credit quality of our loan portfolio, and the continued general decline in the economy. We engaged an outside consultant to perform this additional goodwill impairment testing. Due primarily to the decline in the market value of our stock and the decline in prices paid in comparable bank acquisition transactions between December 31, 2008 and March 31, 2009, the first step of the goodwill impairment test indicated that potential impairment existed and the second step of testing should be performed to determine the amount of impairment. In the second step of the test, our consolidated balance sheet was marked to market to determine the current fair value of the goodwill that should be recorded on the balance sheet. As a result of this testing, we concluded that our goodwill was fully impaired as of March 31, 2009, and we recognized a goodwill impairment charge of $66.8 million ($304,000 of which related to GCM Insurance) for the quarter ended March 31, 2009. This charge eliminated all goodwill previously reflected on our balance sheet.

Income Taxes. The calculation of our income tax provision is complex and requires the use of estimates and judgment in its determination. We are subject to the income tax laws of the various jurisdictions where we conduct business, and we estimate income tax expense based on amounts expected to be owed to these various tax jurisdictions. We assess the appropriate tax treatment of transactions and filing positions after considering statutes, regulations, judicial precedent and other pertinent information, and we maintain tax accruals consistent with our evaluation. Changes in the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations by the taxing authorities, and newly enacted statutory, judicial, and regulatory guidance that could affect the relative merits of the tax positions. These changes, when they occur, impact accrued taxes and can materially affect our operating results. For additional information, see Note J (Income Taxes) of the notes to consolidated financial statements in our December 31, 2008 Form 10-K (audited).

Other Accounting Issues. We own NBC Capital Corporation (MS) Statutory Trust I (the Trust), which was organized under the laws of the State of Connecticut for the purpose of issuing trust preferred securities (TPSs). In accordance with ASC 810, Consolidation, the Trust, which is considered a variable interest entity, is not consolidated into our financial statements because the only activity of the variable interest entity is the issuance of TPSs.

Comparison of Results of Operations for the Nine Months Ended September 30, 2009 and 2008

Net Income/(Loss)

For the first nine months of 2009, we reported a net loss of $112.2 million, or $(9.42) per common share, compared to a net loss of $640,000, or $(0.05) per common share, for the first nine months of 2008. The net loss for the first nine months of 2009 resulted primarily from the $66.8 million impairment loss on goodwill and a $76.5 million provision for loan losses.

Net Interest Income

Net interest income, the primary source of our earnings, represents income generated from earning assets, less the interest expense of funding those assets. Changes in net interest income may be divided into two components: (a) the change in average earning assets (volume component) and (b) the change in the net interest spread (rate component). Net interest spread represents the difference between yields on earning assets and rates paid on interest-bearing liabilities. Net interest margin is net interest income divided by average earning assets.

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Net interest income was $34.6 million for the first nine months of 2009, compared to $42.1 million for the same period of 2008, a decrease of 17.8%. Net interest margin was 2.47% for the first nine months of 2009, compared to 3.10% for the same period of 2008. In comparing the first nine months of 2009 to the same period of 2008, we lost 139 basis points of yield on our earning assets. However, during this same period, our cost of funds decreased by 84 basis points. Average earning assets increased to $1.875 billion for the first nine months of 2009 from $1.814 billion for the first nine months of 2008, an increase of $60.5 million, or 3.3%. This increase is due to an increase in federal funds sold and other interest-bearing assets, from $24.3 million during the first nine months of 2008 to $157.2 million during the first nine months of 2009, as we intentionally built liquidity by accumulating deposits and investing in short-term assets. The increase was somewhat offset by the $83.6 million decrease in average loan balances from the first nine months of 2008 to the first nine months of 2009. From the first nine months of 2008 to the first nine months of 2009, the yield on loans declined from 6.23% to 5.02%, the yield on federal funds sold and other interest-bearing assets declined from 1.84% to 0.23% and the yield on the investment securities portfolio declined from 4.80% to 4.27%.

The following table shows, for the periods indicated, an analysis of net interest earnings, including the average amount of interest-earning assets and interest-bearing liabilities outstanding during the period, the interest earned or paid on those amounts, the average yields/rates paid and the net yield on interest-earning assets:

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(Dollars in thousands)	For the Nine Months Ended September 30, 2009 Average Outstanding Balance	Interest Income/ Expense	Average Yield/Rate (%)	For the Nine Months Ended September 30, 2008 Average Outstanding Balance	Interest Income/ Expense	Average Yield/Rate (%)
Assets:						
Interest-earning assets:						
Loans	$ 1,265,904	$ 47,532	5.02	$ 1,349,528	$ 62,959	6.23
Mortgages held for sale	3,026	107	4.73	3,291	136	5.52
Securities:						
Taxable	373,503	12,083	4.33	324,951	12,240	5.03
Tax exempt	74,919	2,250	4.01	112,021	3,476	4.14
Federal funds sold and other	157,216	273	0.23	24,289	335	1.84
Total interest-earning assets	1,874,568	$ 62,245	4.44	1,814,080	$ 79,146	5.83
Less: Allowance for loan losses	(34,812)			(15,173)		
Noninterest-earning assets	134,827			195,320		
Total assets	$ 1,974,583			$ 1,994,227		
Liabilities and shareholders equity:						
Interest-bearing liabilities:						
Interest checking	$ 265,967	$ 1,989	1.00	$ 237,017	$ 3,044	1.72
Money market and savings	345,037	3,125	1.21	326,463	4,718	1.93
Time deposits	745,493	16,576	2.97	674,653	20,329	4.03
Total interest-bearing deposits	1,356,497	21,690	2.14	1,238,133	28,091	3.03
Borrowings and repurchase agreements	261,429	5,098	2.61	342,980	7,612	2.96
Junior subordinated debentures	30,928	895	3.87	30,928	1,435	6.20
Total interest-bearing liabilities	1,648,854	$ 27,683	2.24	1,612,041	$ 37,138	3.08
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	176,039			177,324		
Other liabilities	14,989			13,110		
Total liabilities	1,839,882			1,802,475		
Shareholders equity	134,701			191,752		
Total liabilities and shareholders equity	$ 1,974,583			$ 1,994,227		
Net interest income		$ 34,562			$ 42,008	
Net interest spread (1)			2.20			2.75
Net interest margin (2)			2.47			3.10

(1) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
(2) Represents net interest income as a percentage of average interest-earning assets.

The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of change to each.

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(In thousands)	Nine Months Ended September 30, 2009 Over Nine Months Ended September 30, 2008		
		Change Due To:	
	Total	Rate	Volume
Interest-earning assets:			
Loans	$ (15,456)	$ (11,716)	$ (3,740)
Securities:			
Taxable	(157)	2,132	(2,289)
Tax exempt	(1,226)	(106)	(1,120)
Federal funds sold and other	(62)	12	(74)
Total interest-earning assets	$ (16,901)	$ (9,678)	$ (7,223)
Interest-bearing liabilities:			
Interest-bearing deposits	$ (6,401)	$ (9,490)	$ 3,089
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase	(3,054)	(1,253)	(1,801)
Total interest-bearing liabilities	$ (9,455)	$ (10,743)	$ 1,288

Provision for Loan Losses

We use our provision for loan losses to replenish the allowance for loan losses on our balance sheet. Based on our evaluation of the risk exposure contained in the loan portfolio, management believes that the level of the allowance is adequate. The board of directors reviews and approves management s evaluation. This is an ongoing process through which we review and determine the amount of the provision on a quarterly basis. The provision for loan losses increased from $18.0 million during the first nine months of 2008 to $76.5 million in the same period of 2009. We incurred $52.3 million in net charge-offs for the first nine months of 2009, compared to $14.8 million for the first nine months of 2008. Also, we significantly increased our allowance for loan losses during the first nine months of 2009. Our allowance for loan losses was $44.9 million at September 30, 2009, compared with our allowance for loan losses at December 31, 2008 of $20.7 million. We have experienced an increase in non-performing loans, mostly due to real estate construction and development loans. During the first nine months of 2009, we noted increased weakness in our Middle Tennessee market.

Other Income (Noninterest Income)

Other income refers to our noninterest income, which includes various service charges, fees and commissions. One of our strategic objectives has been, and continues to be, the diversification of other income sources so that we can be less dependent on net interest income. Our other income, exclusive of securities gains and losses, decreased by $538,000, or 4.1%, from the first nine months of 2008 to the first nine months of 2009. The following table presents for the periods indicated the major categories of noninterest income and the changes in the first nine months of 2009 compared to the first nine months of 2008:

(In thousands)	Nine Months Ended September 30, 2009	2008	Change
Service charges on deposit accounts	$ 6,349	$ 6,791	$ (442)
Trust Department income	1,500	1,684	(184)
Mortgage loan fees	879	983	(104)
Other income	4,017	3,825	192
Total other income	$ 12,745	$ 13,283	$ (538)

Our service charges on deposit accounts, Trust Department income, and mortgage loan fees declined slightly from the first nine months of 2008 to the first nine months of 2009. These income sources were affected by a variety of economic factors. Service charges declined primarily due to fewer insufficient funds fees charged in 2009. Trust Department income was impacted by lower investment balances reflecting the downturn of

the equity markets during the period, and mortgage loan fees were affected by fewer loans closed during the period. The

increase in other noninterest income resulted primarily from insurance proceeds from a bank owned life insurance policy of approximately $645,000 received in the first quarter of 2009, and $150,000 from the reversal of an accrual that was established at the time of our most recent acquisition. During the first nine months of 2008, we recognized a $443,000 gain on the sale of a previously closed branch property, a $232,000 gain on the sale of an asset held by the Corporation and $110,000 in proceeds from the redemption of stock in VISA. The other income balances reflected above do not include other income related to GCM Insurance and the sale of its assets ($3.9 million for the nine months ended September 30, 2009 and $3.8 million for the nine months ended September 30, 2008).

We recognized $1.1 million in securities gains during the first nine months of 2009, compared to $220,000 in gains during the first nine months of 2008. The significant increase in securities gains in 2009 resulted from our selling most of our tax-exempt securities during the third quarter of 2009. Due to our year-to-date results of operations, we were not receiving the full tax benefit of holding these securities. Thus, we decided to sell them and invest the proceeds into higher-yielding taxable securities.

Other Expense (Noninterest Expense)

Noninterest expense represents ordinary overhead expenses and, from time to time, any impairments to goodwill or other intangibles. These expenses increased by $71.6 million during the first nine months of 2009, compared with the first nine months of 2008. The following table presents for the periods indicated the major categories of noninterest expense and the changes in the first nine months of 2009 compared to the first nine months of 2008:

	Nine Months Ended September 30,		
(In thousands)	**2009**	**2008**	**Change**
Salaries and employee benefits	$ 20,984	$ 20,833	$ 151
Premises and fixed asset expense	5,682	5,699	(17)
Impairment loss on goodwill	66,542		66,542
Other expense	19,637	14,736	4,901
Total other expense	$ 112,845	$ 41,268	$ 71,577

In accordance with the provisions of ASC 350 and based on the results of a third party analysis, we recognized a $66.8 million impairment loss on goodwill as of March 31, 2009. This impairment charge eliminated all goodwill from our balance sheet, including approximately $304,000 relating to GCM Insurance (reflected in discontinued operations on the consolidated statement of income). Other noninterest expenses increased by $4.9 million, or 32.5%. This increase is attributable to several factors. FDIC insurance premiums and special assessments totaled $3.4 million for the first nine months of 2009, compared with $605,000 for the first nine months of 2008. In addition, we incurred approximately $934,000 in losses on extinguishment of debt during the third quarter of 2009, as we prepaid several of our FHLB advances. We recognized approximately $966,000 in expenses relating to our efforts to raise capital that were suspended during the third quarter of 2009. Finally, expenses relating to OREO increased from $3.9 million for the first nine months of 2008, to $4.2 million for the first nine months of 2009. The other expense balances reflected above do not include other expenses related to GCM Insurance and the sale of its assets ($3.3 million for the nine months ended September 30, 2009 and $3.4 million for the nine months ended September 30, 2008).

Changes in our income tax expense have generally paralleled changes in income. The income tax benefits for the first nine months of 2008 and 2009 result from the losses recognized for the periods, as well as the tax benefits of our tax-exempt income.

Comparison of Results of Operations for the Quarter Ended September 30, 2009 and 2008

Net Income/(Loss)

For the third quarter of 2009, we reported a net loss applicable to common shareholders of $13.1 million, or $(1.10) per common share, compared to a net loss of $5.3 million, or $(0.44) per common share, for the third quarter of 2008.

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Net Interest Income

Net interest income for the third quarter of 2009 was $11.6 million, compared to $13.5 million for the same quarter of 2008, a decrease of 14.2%. During the third quarter of 2009, the net interest margin was 2.56%, compared to 3.00% for the same period of 2008. This 44 basis point decrease in margin resulted primarily from our intentionally building liquidity by accumulating deposits and investing in short-term assets with lower yields and the fact that we were not able to decrease our cost of funding at the same rate that our yields declined on loans and investment securities. When comparing the third quarter of 2009 to the same quarter of 2008, we lost 98 basis points of yield on our earning assets but only reduced the cost of funds by 66 basis points. Also, a decrease of $22.0 million, or 1.2%, in our average earning assets contributed slightly to the declining net interest income for the third quarter of 2009.

The following table shows, for the periods indicated, an analysis of net interest earnings, including the average amount of interest-earning assets and interest-bearing liabilities outstanding during the period, the interest earned or paid on those amounts, the average yields/rates paid and the net yield on interest-earning assets:

	For the Quarter Ended September 30, 2009			For the Quarter Ended September 30, 2008		
(Dollars in thousands)	**Average Outstanding Balance**	**Interest Income/ Expense**	**Average Yield/Rate (%)**	**Average Outstanding Balance**	**Interest Income/ Expense**	**Average Yield/Rate (%)**
Assets:						
Interest-earning assets:						
Loans	$ 1,218,424	$ 15,430	5.02	$ 1,350,339	$ 19,550	5.76
Mortgages held for sale	2,524	34	5.34	2,421	42	6.90
Securities:						
Taxable	398,883	4,210	4.19	318,814	3,971	4.95
Tax exempt	37,147	398	4.25	113,560	1,169	4.10
Federal funds sold and other	138,279	98	0.28	32,143	134	1.66
Total interest-earning assets	1,795,257	$ 20,170	4.46	1,817,277	$ 24,866	5.44
Less: Allowance for loan losses	(46,692)			(16,219)		
Noninterest-earning assets	134,725			190,394		
Total assets	$ 1,883,290			$ 1,991,452		
Liabilities and shareholders equity:						
Interest-bearing liabilities:						
Interest checking	$ 262,234	$ 637	0.96	$ 263,439	$ 1,095	1.65
Money market and savings	351,193	1,034	1.17	331,101	1,498	1.80
Time deposits	699,951	5,146	2.92	668,028	6,049	3.60
Total interest-bearing deposits	1,313,378	6,817	2.06	1,262,568	8,642	2.72
Borrowings and repurchase agreements	229,642	1,496	2.58	326,056	2,284	2.79
Junior subordinated debentures	30,928	264	3.39	30,928	434	5.58
Total interest-bearing liabilities	1,573,948	$ 8,577	2.16	1,619,552	$ 11,360	2.82
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	176,828			179,673		
Other liabilities	4,510			4,487		
Total liabilities	1,755,286			1,803,712		
Shareholders equity	128,004			187,740		
Total liabilities and shareholders equity	$ 1,883,290			$ 1,991,452		

Net interest income	$ 11,593	$ 13,506
Net interest spread (1)	2.30	2.62
Net interest margin (2)	2.56	3.00

(1) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
(2) Represents net interest income as a percentage of average interest-earning assets.

The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of change to each.

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(In thousands)	Quarter Ended September 30, 2009 Over Quarter Ended September 30, 2008 Total	Change Due To: Rate	Volume
Interest-earning assets:			
Loans	$ (4,128)	$ (2,348)	$ (1,780)
Securities:			
Taxable	239	(2,038)	2,277
Tax exempt	(771)	93	(864)
Federal funds sold and other	(36)	12	(48)
Total interest-earning assets	$ (4,696)	$ (4,281)	$ (415)
Interest-bearing liabilities:			
Interest-bearing deposits	$ (1,825)	$ (2,188)	$ 363
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase	(958)	(287)	(671)
Total interest-bearing liabilities	$ (2,783)	$ (2,475)	$ (308)

Provision for Loan Losses

The provision for loan losses increased from $11.7 million during the third quarter of 2008 to $20.7 million in the third quarter of 2009. This increase was due to an increase in net charge-offs ($22.5 million in the third quarter of 2009 as compared to $9.4 million in the third quarter of 2008), as well as a significant increase in non-performing loans between the third quarter of 2008 and the third quarter of 2009, primarily due to the economy s impact on real estate-based loans.

Other Income (Noninterest Income)

Our noninterest income, exclusive of securities gains and losses, declined by $478,000, or 10.1%, from the third quarter of 2008 to the third quarter of 2009. The following table presents for the periods indicated the major categories of noninterest income and the changes in the third quarter of 2009 compared to the third quarter of 2008:

(In thousands)	Quarter Ended September 30, 2009	2008	Change
Service charges on deposit accounts	$ 2,219	$ 2,453	$ (234)
Trust Department income	527	542	(15)
Mortgage loan fees	242	275	(33)
Other income	1,269	1,465	(196)
Total other income	$ 4,257	$ 4,735	$ (478)

The decline in service charge fee income can be attributed to fewer insufficient funds fees charged during the third quarter of 2009. Other noninterest income decreased by $196,000, or 13.4%, from the third quarter of 2008 to the third quarter of 2009. This decrease is primarily due to the third quarter 2008 recognition of a $443,000 gain on the sale of a previously closed branch property. During the third quarter of 2009, we recognized a gain of approximately $145,000 on the sale of our student loan portfolio.

We recognized $923,000 in securities gains during the third quarter of 2009, compared to gains of $70,000 during the third quarter of 2008. The significant increase in securities gains in 2009 resulted from our selling most of our tax-exempt securities during the third quarter of 2009. Due to our year-to-date results of operations, we were not receiving the tax benefit of holding these securities. Thus, we decided to sell them and invest the proceeds into higher-yielding taxable securities.

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Other Expense (Noninterest Expense)

Noninterest expenses increased by $1.4 million, or 7.9%, during the third quarter of 2009, compared with the third quarter of 2008. The following table presents for the periods indicated the major categories of noninterest expense and the changes in the third quarter of 2009 compared to the third quarter of 2008:

	Quarter Ended September 30,		
(In thousands)	**2009**	**2008**	**Change**
Salaries and employee benefits	$ 6,902	$ 6,829	$ 73
Premises and fixed asset expense	1,910	1,896	14
Other expense	8,558	7,281	1,277
Total other expense	$ 17,370	$ 16,006	$ 1,364

Our other noninterest expenses increased by $1.3 million, or 17.5%, from the third quarter of 2008 to the third quarter of 2009, due primarily to increases in FDIC insurance premiums and expenses relating to OREO. FDIC insurance premiums and special assessments increased from $267,000 in the third quarter of 2008 to $1.2 million in the third quarter of 2009. In addition, we incurred approximately $934,000 in losses on extinguishment or debt during the third quarter of 2009, as we prepaid several of our FHLB advances. Also, we recognized approximately $966,000 in expenses relating to our outstanding shelf offering filed with the SEC in July. Partially offsetting the impact of these expenses was a decline in OREO-related expenses, from $3.5 million in the third quarter of 2008 to $2.0 million in the third quarter of 2009. The 2008 expenses include approximately $3.2 million in losses on the sale of OREO, while the 2009 expenses include approximately $1.5 million in losses on the sale of OREO.

Changes in our income tax expense have generally paralleled changes in income. The income tax benefits for the third quarters of 2008 and 2009 result from the losses recognized for the periods, as well as the tax benefits of our tax-exempt income.

Financial Condition as of September 30, 2009

Summary

Total assets were $1.768 billion as of September 30, 2009, compared to $1.979 billion as of December 31, 2008. Our loan portfolio balance was $1.180 billion as of September 30, 2009, compared to $1.328 billion as of December 31, 2008, a decrease of $148.6 million, or 11.2%. Our investment portfolio balance was $420.3 million as of September 30, 2009, compared to $436.4 million as of December 31, 2008, a decrease of $16.1 million, or 3.7%. Total deposits were $1.411 billion as of September 30, 2009, compared to $1.461 billion as of December 31, 2008, a decrease of $49.7 million, or 3.4%. Shareholders equity was $120.8 million as of September 30, 2009, compared to $185.6 million as of December 31, 2008, a decrease of $64.8 million, or 34.9%.

Loan Portfolio

Historically, our lending focus has been distributed among commercial real estate, commercial and industrial loans, 1-4 family mortgages and consumer loans. Total commercial, financial and agricultural loans, which consist primarily of short-term loans for working capital purposes, inventories, seasonal loans, lines of credit and equipment loans, accounted for 16.5% of our loan portfolio as of September 30, 2009, compared to 16.5% as of December 31, 2008. Total real estate loans, which are secured by commercial real estate, one-to-four family residential properties and multi-family dwelling units, accounted for 73.9% of our loan portfolio as of September 30, 2009, compared to 76.0% as of December 31, 2008. Total consumer loans, which consist of home improvement, mobile home, automobile and unsecured personal loans, made up 1.8% of our loan portfolio as of September 30, 2009, compared to 2.3% as of December 31, 2008.

Total loans were $1.180 billion as of September 30, 2009, a decrease of $148.6 million, or 11.2%, compared to total loans of $1.328 billion as of December 31, 2008. The majority of the decline in loans occurred in commercial real estate loans and construction and development loans due primarily to payoffs and chargedowns.

The following table summarizes our loan portfolio by type of loan and type of customer as of the dates indicated:

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(Dollars in thousands)	As of September 30, 2009 Amount	Percent	As of December 31, 2008 Amount	Percent
Commercial:				
Commercial	$ 194,662	16.5%	$ 219,236	16.5%
Commercial real estate	657,668	55.7%	670,595	50.5%
Real estate construction	59,372	5.0%	179,381	13.5%
Total commercial	911,702	77.2%	1,069,212	80.5%
Consumer:				
Residential real estate	85,616	7.3%	92,055	6.9%
Home equity lines	69,116	5.9%	67,708	5.1%
Other consumer loans	21,223	1.8%	30,921	2.3%
Total consumer	175,955	15.0%	190,684	14.3%
Other	92,084	7.8%	68,433	5.2%
Total loans	$ 1,179,741	100.0%	$ 1,328,329	100.0%

The contractual maturity ranges of our loan portfolio and the amount of such loans with fixed and variable interest rates in each maturity range classified by borrower type as of September 30, 2009, are summarized in the following table:

(In thousands)	As of September 30, 2009 One Year or Less	After One Through Five Years	After Five Years	Total
Commercial:				
Commercial	$ 78,333	$ 109,713	$ 6,616	$ 194,662
Commercial real estate	189,050	358,035	110,583	657,668
Real estate construction	45,357	5,261	8,754	59,372
Total commercial	312,740	473,009	125,953	911,702
Consumer:				
Residential real estate	9,870	24,274	51,472	85,616
Home equity lines	1,279	13,862	53,975	69,116
Other consumer loans	5,225	11,696	4,302	21,223
Total consumer	16,374	49,832	109,749	175,955
Other	80,706	10,936	442	92,084
Total loans	$ 409,820	$ 533,777	$ 236,144	$ 1,179,741
Loans with a fixed interest rate	$ 111,348	$ 317,766	$ 47,090	$ 476,204
Loans with a variable interest rate	298,472	216,011	189,054	703,537

Total loans	$ 409,820	$ 533,777	$ 236,144	$ 1,179,741

As of September 30, 2009, our loan portfolio was composed of approximately 40.0% fixed interest rate loans and 60.0% variable interest rate loans. Scheduled contractual principal repayments do not reflect the actual maturities of loans. The average maturity of our loans is substantially less than their average contractual term because of prepayments. The average life of mortgage loans tends to increase when the current mortgage loan rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when current mortgage loans rates are substantially lower than rates on existing mortgages due primarily to refinancings of adjustable rate and fixed rate loans at lower rates.

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Higher-Risk Loans

Our loan portfolio does not include several types of loans generally considered higher-risk, such as option adjustable-rate mortgage loans, junior lien mortgages, high loan-to-value mortgages, interest-only loans, subprime loans, and loans with teaser rates. Management believes that the highest risk loans in our portfolio are our construction and land development loans.

We entered the Memphis, Birmingham, and Middle Tennessee markets late in the most recent real estate boom cycle. Consequently, our build-up in our construction and land development portfolio and the subsequent lack of demand for residential real estate due to declines in the mortgage markets caused our loan quality to deteriorate. In mid-2008, we established a moratorium on residential construction and development lending. From September 30, 2008 to September 30, 2009, we reduced our exposure in our construction and land development portfolio by $179.5 million, or 45.3%.

The following table reflects the composition of our construction and land development portfolio by market:

(In thousands)	As of September 30, 2009		As of June 30, 2009		As of December 31, 2008		As of September 30, 2008	
	Balance	%	Balance	%	Balance	%	Balance	%
Birmingham	$ 18,423	8.5%	$ 20,009	7.9%	$ 24,470	7.0%	$ 27,771	7.0%
Florida	25,427	11.7%	26,430	10.5%	30,673	8.7%	47,600	12.0%
Georgia	11,481	5.3%	11,763	4.7%	12,883	3.7%	14,121	3.6%
Memphis	41,561	19.2%	49,086	19.5%	86,615	24.6%	107,998	27.3%
Middle Tennessee	76,226	35.2%	102,063	40.5%	142,895	40.6%	144,401	36.4%
Mississippi	31,959	14.7%	30,362	12.1%	38,508	10.9%	37,829	9.5%
Tuscaloosa	11,639	5.4%	12,054	4.8%	15,892	4.5%	16,535	4.2%
Total	$ 216,716	100.0%	$ 251,767	100.0%	$ 351,936	100.0%	$ 396,255	100.0%

During 2009, we have charged off approximately $35.0 million related to loans in this segment of our portfolio. As of September 30, 2009, our allowance for loan losses includes approximately $27.5 million allocated to construction and land development loans.

All commercial real estate loans, exclusive of the loans discussed above, total approximately $477.9 million as of September 30, 2009. Of this total, 53% represent owner occupied commercial real estate, and 47% represent non-owner occupied commercial real estate.

We have implemented additional risk management procedures focusing on real estate loans, so that we will reduce potential future losses. The moratorium on residential construction and development lending is continuing. We have tightened our underwriting standards for all commercial real estate loans and are not renewing certain loans to move them out of our portfolio. We are conducting builder/developer stress tests for any relationships of one million dollars or greater, and our loan officers are focusing more time on managing and reviewing existing loans, including stress testing, clearing exceptions, and collecting these loans.

We are beginning to see some positive signs in these portfolios; however, we are not ready to say that they have turned upward. We remain very proactive in monitoring these credits across our system since they represent the biggest risk to our future earnings.

Delinquent and Nonperforming Assets

We have several procedures that are designed to maintain the overall quality of our loan portfolio. We have established underwriting guidelines followed by our management and delinquency levels are monitored by our executive committee and reviewed by the board of directors for any negative or adverse trends. There can be no assurance, however, that our loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

Trends in delinquency ratios represent an indicator, among other considerations, of credit risk within the loan portfolio. Nonperforming loans include nonaccrual loans, loans past due 90 days or more, and loans renegotiated or restructured because of a debtor s financial difficulties.

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We generally place loans on nonaccrual status if any of the following events occur:

- the classification of a loan as nonaccrual internally or by regulatory examiners;
- delinquency on principal for 90 days or more unless management is in the process of collection;
- a balance remains after repossession of collateral;
- notification of bankruptcy; or
- management judges that nonaccrual status is appropriate.

Cash payments received while a loan is classified as nonaccrual are recorded as a reduction of principal as long as doubt exists as to collection. We are sometimes required to revise the interest rate or repayment terms in a troubled debt restructuring.

We obtain appraisals on loans secured by real estate with principal amounts in excess of $250,000 and may update those appraisals for loans categorized as nonperforming loans and potential problem loans. In instances where updated appraisals reflect reduced collateral values, we evaluate the borrower s overall financial condition to determine the need, if any, for possible writedowns or appropriate additions to the allowance for loan losses. We record real estate acquired through foreclosure at fair value at the time of acquisition, less estimated costs to sell the property.

The following table presents information regarding nonperforming assets as of the dates indicated:

(Dollars in thousands)	As of September 30, 2009	As of December 31, 2008
Nonaccrual loans	$ 46,983	$ 23,761
Accruing loans past due 90 days or more	4,083	3,467
Restructured loans	8,918	4,397
Total nonperforming loans	59,984	31,625
Other real estate	14,760	18,691
Total nonperforming assets	$ 74,744	$ 50,316
Nonperforming assets to total loans and other real estate	6.26%	3.74%

Nonperforming assets were $74.7 million as of September 30, 2009, compared to $50.3 million as of December 31, 2008. Our ratio of nonperforming assets to total loans and other real estate was 6.26% as of September 30, 2009, compared to 3.74% as of December 31, 2008. The increase in nonperforming assets in the first nine months of 2009 was due primarily to the continued decline in the economy, resulting in continued deterioration in the construction and development sector of our loan portfolio.

As of September 30, 2009, other real estate was comprised primarily of residential real estate developments in various stages of completion.

We follow a loan review program designed to evaluate the credit risk in our loan portfolio. Through this loan review process, we maintain an internally classified watch list which helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans included on the watch list that are not otherwise classified show warning elements where the present status portrays one or

more deficiencies that require attention in the short term or where pertinent ratios of the loan account have weakened to a point where more frequent monitoring is warranted. These loans do not have all of the characteristics of a classified loan (substandard or doubtful) but do show weakened elements compared to those of a satisfactory credit.

In establishing the appropriate classification for specific assets, we consider, among other factors, the estimated value of the underlying collateral, the borrower s ability to repay, the borrower s repayment history and the current delinquent status. As a result of this process, loans are classified as substandard, doubtful or loss.

Loans classified as substandard are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition which may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that we will sustain some losses if the deficiencies are not corrected. Loans classified as doubtful are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in

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full is highly questionable and improbable. Loans classified as loss are those loans that are in the process of being charged off. Once a loan is deemed uncollectible as contractually agreed, the loan is charged off either partially or in-full against the allowance for loan losses.

Allowance for Loan Losses

The allowance for loan losses was $44.9 million as of September 30, 2009, compared to $20.7 million as of December 31, 2008. This increase reflects further deterioration in our loan portfolio, due primarily to the lack of demand for residential housing, and the subsequent increase in net charge-offs.

The following table summarizes the activity in our allowance for loan losses as of and for the periods indicated:

(Dollars in thousands)	As of September 30, 2009	As of December 31, 2008
Average loans outstanding	$ 1,268,930	$ 1,350,869
Total loans outstanding at end of period	$ 1,179,741	$ 1,328,329
Allowance for loan losses at beginning of period	$ 20,730	$ 14,926
Charge-offs:		
Commercial, financial and agricultural	(7,922)	(1,582)
Real estate	(44,459)	(21,000)
Installment loans and other	(555)	(1,339)
Total charge-offs	(52,936)	(23,921)
Recoveries:		
Commercial, financial and agricultural	201	379
Real estate	259	322
Installment loans and other	225	425
Total recoveries	685	1,126
Net charge-offs	(52,251)	(22,795)
Provision for loan losses	76,460	28,599
Allowance for loan losses at end of period	$ 44,939	$ 20,730
Ratio of net charge-offs to average loans outstanding	4.12%	1.69%
Ratio of allowance for loan losses to period end loans	3.81%	1.56%
Ratio of allowance for loan losses to nonperforming loans	74.92%	65.55%

Allocated Allowance for Loan Losses. We use a risk rating and specific reserve methodology in the calculation and allocation of our allowance for loan losses. The following table describes the allocation of the allowance for loan losses among various categories of loans for the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

(In thousands)	As of September 30, 2009		As of December 31, 2008	
	Loan Balance	Allowance for Loan	Loan Balance	Allowance for Loan

		Losses		Losses
Allocated component:				
Impaired loans	$ 60,824	$ 6,198	$ 59,664	$ 10,075
Pooled loans	1,118,917	35,669	1,268,665	6,655
Unallocated component		3,072		4,000
Totals	$ 1,179,741	$ 44,939	$ 1,328,329	$ 20,730

Management believes that the allowance for loan losses as of September 30, 2009 is adequate to cover losses inherent in the portfolio as of such date. There can be no assurance, however, that we will not sustain losses in future periods, which could be substantial in relation to the size of the allowance for loan losses as of September 30, 2009.

Investment Portfolio

The investment portfolio serves as a source of liquidity and earnings and is used to manage interest rate risk and to ensure collateral is available for pledging requirements. Our investment portfolio primarily consists of agency mortgage-backed securities, pooled government guaranteed SBA loans and taxable and non-taxable municipal securities. Securities within the portfolio are classified as held-to-maturity or available-for-sale. As of September 30, 2009, we had no securities classified as trading. Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

Securities available-for-sale are carried at fair value with unrealized holding gains and losses reported as a separate component of shareholders equity called accumulated other comprehensive income. Securities that are held as available-for-sale are used as a part of our asset/liability management strategy. Securities may be sold in response to interest rate changes, changes in liquidity needs, changes in tax strategies, changes in prepayment risk or changes to underlying bank funding. Available-for-sale securities were $403.4 million as of September 30, 2009, compared to $398.7 million as of December 31, 2008. As of September 30, 2009, $224.2 million, or 55.6%, of the available-for-sale securities were invested in mortgage-backed securities, compared to $220.5 million, or 55.3%, as of December 31, 2008. The remainder of the available-for-sale portfolio was invested primarily in government securities.

Securities held-to-maturity are carried at amortized historical cost. Securities that we have the intent and ability to hold until maturity or on a long-term basis are classified as held-to-maturity. Held-to-maturity securities were $2.7 million as of September 30, 2009, compared to $21.4 million as of December 31, 2008. All of the securities in the held-to-maturity category were issued by state and municipal subdivisions. During the third quarter of 2009, we evaluated our portfolio and determined that we were not receiving the full tax benefit of holding tax-exempt securities, based on our year-to-date results of operations. Thus, with the approval of the Board of Directors, we sold most of those securities and invested the proceeds into higher-yielding taxable securities. These securities are reflected in the securities available-for-sale caption on our consolidated balance sheet as of September 30, 2009.

The following tables summarize the amortized cost of securities classified as available-for-sale and held-to-maturity and their approximate fair values as of the dates shown:

	As of September 30, 2009			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available-for-sale:				
Mortgage-backed securities	$ 214,411	$ 9,805	$ 23	$ 224,193
Other securities	175,535	4,114	446	179,203
Total	$ 389,946	$ 13,919	$ 469	$ 403,396
Held-to-maturity:				
Mortgage-backed securities	$	$	$	$
Other securities	2,673	100		2,773
Total	$ 2,673	$ 100	$	$ 2,773

	As of December 31, 2008			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available-for-sale:				
Mortgage-backed securities	$ 213,736	$ 6,736	$ 17	$ 220,455
Other securities	177,528	2,168	1,449	178,247
Total	$ 391,264	$ 8,904	$ 1,466	$ 398,702
Held-to-maturity:				
Mortgage-backed securities	$	$	$	$
Other securities	21,358	757		22,115
Total	$ 21,358	$ 757	$	$ 22,115

Some of our investment securities are valued at less than their historical cost. We believe these declines resulted primarily from increases in market interest rates. Because the declines in market value are due to changes in interest rates and not credit quality, and because we have the ability and intent to hold these securities until a recovery in fair value, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net earnings in the period the other-than-temporary impairment is identified.

As of September 30, 2009, we had net unrealized gains of $13.6 million in the investment portfolio compared to net unrealized gains of $8.2 million as of December 31, 2008. The $5.4 million increase in net unrealized gains is primarily attributable to changes in market interest rates from December 31, 2008 to September 30, 2009.

Mortgage-backed securities (MBSs) are securities that have been developed by pooling a number of real estate mortgages and are principally issued by quasi-federal agencies such as Fannie Mae and Freddie Mac. These securities are deemed to have high credit ratings, and the minimum monthly cash flows of principal and interest are guaranteed by the issuing agencies. Although investors generally assume that the federal government will support these agencies, it is under no obligation to do so. Other MBSs are issued by Ginnie Mae, which is a federal agency, and are guaranteed by the U.S. government.

Unlike U.S. government securities, which have a lump sum payment at maturity, MBSs provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. MBSs that are purchased at a premium will generally suffer decreasing net yields as interest rates drop because homeowners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Conversely, MBSs purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate MBSs do not tend to experience heavy prepayments of principal, and consequently the average life of this security will be lengthened. If interest rates begin to fall, prepayments will increase, thereby shortening the estimated lives of these securities.

The following table summarizes the contractual maturities of investment securities on an amortized cost basis and their weighted average yields as of September 30, 2009. This table shows the contractual maturities of the related investment securities and not the estimated average lives of the securities. The contractual maturity of an MBS is the date at which the last underlying mortgage matures. In the case of a 15-year pool of loans or a 30-year pool of loans, the maturity date of the security will be the date the last payment is due on the underlying mortgages.

	As of September 30, 2009									
	Due Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available-for-sale:										
Mortgage-backed securities	$		$ 13,220	4.07%	$ 20,354	4.90%	$ 190,619	5.06%	$ 224,193	4.98%
Other securities	53,338	0.30%	6,923	4.22%	10,219	4.79%	107,554	4.49%	178,034	3.24%
Total	53,338	0.30%	20,143	4.12%	30,573	4.87%	298,173	4.85%	402,227	4.21%
Held-to-maturity:										
Mortgage-backed securities										
Other securities					613	10.01%	2,060	9.19%	2,673	9.37%
Total					613	10.01%	2,060	9.19%	2,673	9.37%
Equity and other securities			290	7.37%		0.00%	15,128	2.40%	15,418	2.49%
Total securities	$ 53,338	0.30%	$ 20,433	4.17%	$ 31,186	4.97%	$ 315,361	4.76%	$ 420,318	4.18%

Contractual maturity of an MBS is not a reliable indicator of its expected life because borrowers have the right to prepay their obligations at any time. A third party analysis of our mortgage-backed securities as of September 30, 2009 showed the estimated average lives for fixed MBSs to be 3.7 years. The average life of the total investment portfolio is 4.1 years as of September 30, 2009.

Goodwill and Other Intangibles

The change in our carrying amount of goodwill and other intangible assets as of September 30, 2009 and as of December 31, 2008 was as follows:

(In thousands)	As of September 30, 2009	As of December 31, 2008
Balance, beginning	$ 68,849	$ 69,738
Intangible asset amortization	(485)	(889)
Goodwill impairment charge	(66,846)	
Balance, ending	$ 1,518	$ 68,849

The change resulted from the decline in the market value of our stock and the decline in prices paid in comparable acquisition transactions.

Deposits

Deposits are our primary source of funds and we rely on our banking centers and branches to attract and retain those deposits. We offer a variety of products, which consist of noninterest-bearing and interest checking accounts, money market and savings accounts and certificates of deposit.

Deposits are gathered from individuals, partnerships and corporations in our market areas. From time to time, we also purchase brokered deposits. Our deposits averaged $1.533 billion for the first nine months of 2009, compared to $1.416 billion for the year ended December 31, 2008.

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As of September 30, 2009, core deposits (which consist of all deposits other than brokered deposits, 50% of time deposits $100,000 and greater and 50% of public funds) were $1.123 billion, or 79.6% of total deposits, while non-core deposits, including brokered deposits, made up 20.4% of total deposits. Total deposits declined to $1.411 billion as of September 30, 2009, compared to $1.461 billion as of December 31, 2008, a decrease of $49.7 million, or 3.4%. The decrease resulted from a $36.8 million, or 2.9%, decrease in interest-bearing deposits, primarily time deposits, and a $12.9 million, or 7.1%, decrease in noninterest-bearing deposits.

The interest rates we pay are based on the competitive environments in each of our markets. We manage our interest expense through weekly deposit pricing reviews that compare our deposit rates with the competition and wholesale alternatives. The rising cost of our deposits over the past few years reflects the impact of the increase in the Federal Funds rate from 2006 through 2008. In addition, we have at times offered special products or attractive rates so that our deposits will keep up with our loan growth. The average cost of deposits, including noninterest-bearing deposits, for the first nine months of 2009 was 1.89%, compared to 2.52% for the year ended December 31, 2008.

The following table presents the daily average balances and rates paid on deposits for the periods indicated:

	Nine Months Ended September 30, 2009		Year Ended December 31, 2008	
(Dollars in thousands)	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**
Noninterest-bearing deposits	$ 176,039	0.00%	$ 177,670	0.00%
Interest-bearing demand (1)	567,483	1.17%	526,918	1.80%
Savings	43,521	0.43%	40,261	0.58%
Time deposits less than $100,000	303,602	2.89%	287,987	3.76%
Core deposits	1,090,645	1.43%	1,032,836	1.99%
Time deposits $100,000 and greater	318,001	2.85%	287,621	3.79%
Brokered deposits	123,890	3.49%	95,369	4.41%
Total	$ 1,532,536	1.89%	$ 1,415,826	2.52%

(1) Includes money market accounts.

The following table provides the amount of our time deposits as of September 30, 2009 that are $100,000 and greater by time remaining until maturity:

(In thousands)	**As of September 30, 2009**
Three months or less	$ 87,004
Over three months through six months	114,865
Over six months through one year	94,237
Over one year	58,625
Total	$ 354,731

While a majority of the time deposits in amounts of $100,000 and greater will mature within one year, we expect that a significant portion of these deposits will be renewed, given that the rates we offer on time deposits are competitive in the market. If a significant portion of the time deposits were not renewed, it would have an adverse effect on our liquidity. We monitor maturities and have other available funding sources to mitigate this effect.

Borrowings, Repurchase Agreements and Junior Subordinated Debentures

We use borrowings to supplement deposits in funding our lending and investing activities. These borrowings are typically FHLB advances, which have terms ranging from overnight to several years. All FHLB borrowings are collateralized by investment securities or first mortgage loans. Additionally, we borrow from other financial institutions using investment securities as collateral and have issued junior subordinated debentures to a subsidiary trust.

Our borrowings and repurchase agreements were $190.5 million as of September 30, 2009. The outstanding balance as of September 30, 2009 includes $100.0 million in long-term FHLB advances, $50.0 million in repurchase agreements with brokerage firms and $40.5 million in repurchase agreements with clients and treasury tax and loan note payable.

We decreased our borrowing and repurchase agreements by $97.0 million, or 33.7%, from December 31, 2008 to September 30, 2009. The decrease was primarily a result of rising deposits, which provided us with a less expensive and more stable funding source, than borrowings and repurchase agreements.

The following table summarizes our outstanding borrowings and repurchase agreements of the dates indicated:

(Dollars in thousands)	As of September 30, 2009	As of December 31, 2008
Ending balance	$ 190,500	$ 287,465
Average balance for the period	261,429	339,430
Maximum month-end balance during the period	284,664	389,309
Average interest rate for the period	2.61%	2.85%
Weighted average interest rate at the end of the period	2.47%	2.51%

Note: This schedule includes federal funds purchased, securities sold under agreements to repurchase, and other borrowed funds (primarily FHLB advances).

In addition to the borrowings and repurchase agreements discussed above, on December 20, 2003, the Corporation issued $30.9 million of floating rate junior subordinated deferrable interest debentures to the Trust. The debentures are the sole asset of the Trust. The net proceeds received by the Corporation from the issuance of the debentures were used for our acquisition of Enterprise Bancshares, Inc. The Trust issued $30.0 million of TPSs to investors. The Corporation s obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Corporation of the Trust s obligations under the TPSs. The TPSs are redeemable at the Corporation s option on or after December 30, 2008, on any interest payment date. The TPSs must be redeemed upon maturity of the debentures in 2033. Interest on the debentures and TPSs is the three month London Interbank Offer Rate (LIBOR) plus 2.85% and is payable quarterly.

The Trust is a statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in our junior subordinated debentures. The TPSs represent preferred beneficial interests in the assets of the Trust and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the Trust. We own the common securities of the Trust. The Trust s ability to pay amounts due on the TPSs depends solely on our making payment on the related junior subordinated debentures. The debentures, which are the only assets of the Trust, are subordinate and junior in right of payment to all of our present and future senior indebtedness.

Under the provisions of the issue of the junior subordinated debentures, we have the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on the junior subordinated debentures are deferred, the distributions on the TPSs will also be deferred. However, the interest due would continue to accrue during any such interest payment deferral period.

The TPSs issued by the Trust are currently included in our Tier 1 capital for regulatory purposes. On March 1, 2005, the Federal Reserve adopted final rules that continued to allow trust preferred securities to be included in Tier 1 capital, but subject to stricter quantitative and qualitative limits that took effect on March 31, 2009. Prior to March 31, 2009, trust preferred securities and qualifying perpetual preferred stock were limited in the aggregate to no more than 25% of a bank holding company s core capital elements. The new rule amends the existing limit by providing that the aggregate amount of restricted core capital elements (including trust preferred securities and qualifying perpetual preferred stock) that may be included in Tier 1 capital may not exceed 25% of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Because the 25% limit was previously calculated without deducting goodwill, the final rule reduced the amount of TPSs that we can include in Tier 1 capital. The rules that became effective on March 31, 2009 did not affect the amount of TPSs that we may include in our Tier 1 capital.

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The Trust issuing the TPSs holds junior subordinated debentures we issued with a 30-year maturity. The final rules provide that in the last five years before the junior subordinated debentures mature, the associated TPSs will be excluded from Tier 1 capital and included in Tier 2 capital, subject (together with subordinated debt and certain other investments) to an aggregate limit of 50% of Tier 1 capital. In addition, under the proposal, the TPSs during this five-year period would be amortized out of Tier 2 capital by one-fifth each year and excluded from Tier 2 capital completely during the year prior to maturity of the debentures.

Shareholders Equity

Shareholders equity was $120.8 million as of September 30, 2009, compared to $185.6 million as of December 31, 2008. Our ratio of average shareholders equity to average assets decreased to 6.8% as of September 30, 2009, compared to 9.6% as of December 31, 2008. On January 9, 2009, we sold $44 million of non-voting Series A preferred stock to the U.S. Treasury under the CPP. During the first nine months of 2009, we reported a net loss applicable to common shareholders of $112.2 million. Included in this amount are the payment of $1.3 million in preferred dividends and $306,000 of discount accretion related to the Series A preferred stock. Also, we declared common dividends to our shareholders of $595,000 for the first quarter of 2009. Finally, an increase in the market value of our available-for-sale investment securities caused our accumulated other comprehensive income to increase from $237,000 at December 31, 2008, to $3.9 million at September 30, 2009.

Dividends paid by the Corporation are provided from dividends received from the Bank. Under regulations controlling national banks, the payment of dividends by a bank without prior approval from the OCC is limited in amount to the current year s net profit and the retained net earnings of the two preceding years. At December 31, 2008 and September 30, 2009, without approval from the OCC, the Bank does not have the ability to pay dividends to the Corporation. On May 5, 2009, our board of directors voted to suspend paying cash dividends until further notice.

Return on Equity and Assets

The following table sets forth certain selected financial data for the periods indicated.

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2009	2008	2009	2008
Return on assets (net income divided by total average assets)	(7.7)%	0.0%	(2.8)%	(1.1)%
Return on equity (net income divided by average equity)	(102.9)%	(0.4)%	$ 209	$ 405

(a) As of December 31, 2013, we had no borrowings under the $50 million credit agreement described above.

(b) Purchase obligations within less than one year include: (i) the purchase of biodiesel feedstock to be taken during 2014; and (ii) various other infrastructure and capital repairs.

(c) A component of other noncurrent liabilities is a reserve for asset retirement obligations and environmental contingencies of $771 at December 31, 2013. We are liable for these asset retirement obligations and environmental contingencies only in certain events, primarily the closure of our Batesville, Arkansas facility. As such, we do not expect a payment related to these liabilities in the foreseeable future and therefore we have excluded this amount from the table above.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

In recent years, general economic inflation has not had a material adverse impact on our costs and, as described elsewhere herein, we have passed some price increases along to our customers. However, we are subject to certain market risks as described below.

Market risk represents the potential loss arising from adverse changes in market rates and prices. Commodity price risk is inherent in the chemical and biofuels business both with respect to input (electricity, coal, raw materials, biofuel feedstocks, etc.) and output (manufactured chemicals and biofuels).

We seek to mitigate our market risks associated with the manufacturing and sale of chemicals by entering into term sale contracts that include contractual market price adjustment protections to allow changes in market prices of key raw materials to be passed on to the customer. Such price protections are not always obtained, however, so raw material price risk remains a significant risk.

In order to manage price risk caused by market fluctuations in biofuel prices, we may enter into exchange traded commodity futures and options contracts. We account for these derivative instruments in accordance with ASC 815-20-25, *Derivatives and Hedging, Hedging-General, Recognition*. Under this standard, the accounting for changes in the fair value of a derivative instrument depends upon whether it has been designated as an accounting hedging relationship and, further, on the type of hedging relationship. To qualify for designation as an accounting hedging relationship, specific criteria must be met and appropriate documentation maintained. We had no derivative instruments that qualified under these rules as designated accounting hedges in 2013 or 2012. Changes in the fair value of our derivative instruments are recognized at the end of each accounting period and recorded in the statement of operations as a component of cost of goods sold.

Our immediate recognition of derivative instrument gains and losses can cause net income to be volatile from period to period due to the timing of the change in value of the derivative instruments relative to the sale of biofuel being sold. As of December 31, 2013 and 2012, the fair values of our derivative instruments were a net liability in the amount of $328,000 and $947,000, respectively.

Our gross profit will be impacted by the prices we pay for raw materials and conversion costs (costs incurred in the production of chemicals and biofuels) for which we do not possess contractual market price adjustment protection. These items are principally comprised of crude corn oil and yellow grease and petrodiesel. The availability and price of these items are subject to wide fluctuations due to unpredictable factors such as weather conditions, overall economic conditions, governmental policies, commodity markets, and global supply and demand.

We prepared a sensitivity analysis of our exposure to market risk with respect to key raw materials and conversion costs for which we do not possess contractual market price adjustment protections, based on average prices in 2013. We included only those raw materials and conversion costs for which a hypothetical adverse change in price would result in a 1% or greater decrease in gross profit. Assuming that the prices of the associated finished goods could not be increased and assuming no change in quantities sold, a hypothetical 10% change in the average price of the commodities listed below would result in the following change in annual gross profit.

(Volumes and dollars in thousands)

Item	**Volume[(a)] Requirements**	**Units**	**Hypothetical Adverse Change in Price**	**Decrease in Gross Profit**	**Percentage Decrease in Gross Profit**	
Crude corn oil and yellow grease	385,429	LB	10%	$ 14,646	14.6	%
Petrodiesel	19,261	GAL	10%	$ 5,853	5.8	%
Electricity	102	MWH	10%	$ 3,281	3.3	%

(a) Volume requirements and average price information are based upon volumes used and prices obtained for the twelve months ended December 31, 2013. Volume requirements may differ materially from these quantities in future years as our business evolves.

We had no borrowings as of December 31, 2013 or 2012 and, as such, we were not exposed to interest rate risk for those years. Due to the relative insignificance of transactions denominated in a foreign currency, we consider our foreign currency risk to be immaterial.

Item 8. Financial Statements and Supplementary Data.

Financial Statements.

The following sets forth our consolidated balance sheets as at December 31, 2013 and 2012 and our consolidated statements of operations, statements of cash flows, and statements of stockholders' equity for each of the three years in the period ended December 31, 2013, together with RubinBrown LLP's report thereon.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

FutureFuel Corp.:

We have audited the accompanying consolidated balance sheets of FutureFuel Corp. and subsidiaries (the Company) as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013. FutureFuel Corp.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FutureFuel Corp. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), FutureFuel Corp. and subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 17, 2014 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ RubinBrown LLP

St. Louis, Missouri

March 17, 2014

FutureFuel Corp.

Consolidated Balance Sheets

As of December 31, 2013 and 2012

(Dollars in thousands)

	2013	2012
Assets		
Cash and cash equivalents	$86,463	$58,737
Accounts receivable, net of allowances of $0 and $0, respectively	28,620	22,782
Accounts receivable – related parties	4,629	-
Inventory	42,164	41,992
Income tax receivable	14,732	-
Prepaid expenses	1,843	1,595
Prepaid expenses – related parties	-	32
Marketable securities	104,271	87,768
Other current assets	566	1,030
Total current assets	283,288	213,936
Property, plant and equipment, net	128,671	138,865
Other assets	2,488	2,436
Total noncurrent assets	131,159	141,301
Total Assets	$414,447	$355,237
Liabilities and Stockholders' Equity		
Accounts payable	$14,927	$12,589
Accounts payable - related parties	857	3,887
Income taxes payable	-	620
Current deferred income tax liability	8,787	6,953
Deferred revenue – short-term	6,869	6,071
Contingent liability – short-term	1,151	2,521
Accrued expenses and other current liabilities	7,802	3,593
Accrued expenses and other current liabilities - related parties	3	-
Total current liabilities	40,396	36,234
Deferred revenue – long-term	13,522	27,684
Other noncurrent liabilities	2,690	948
Noncurrent deferred income tax liability	29,249	30,037
Total noncurrent liabilities	45,461	58,669
Total Liabilities	85,857	94,903
Commitments and contingencies (Notes 2, 15, 22, and 28)		
Preferred stock, $0.0001 par value, 5,000,000 shares authorized, none issued and outstanding	-	-
Common stock, $0.0001 par value, 75,000,000 shares authorized, 43,342,830 and 41,739,569 issued and outstanding as of December 31, 2013 and 2012, respectively	4	4

Accumulated other comprehensive income	7,436	2,597
Additional paid in capital	276,328	257,041
Retained earnings	44,822	692
Total stockholders' equity	328,590	260,334
Total Liabilities and Stockholders' Equity	$414,447	$355,237

The accompanying notes are an integral part of these financial statements.

FutureFuel Corp.

Consolidated Statements of Operations

For the Years Ended December 31, 2013, 2012, and 2011

(Dollars in thousands, except per share amounts)

	2013	**2012**	**2011**
Revenues	$435,499	$338,812	$304,614
Revenues – related parties	9,420	13,017	5,271
Cost of goods sold	325,099	280,377	237,867
Cost of goods sold – related parties	15,364	9,366	6,996
Distribution	3,899	4,362	2,824
Distribution - related parties	392	471	443
Gross profit	100,165	57,253	61,755
Selling, general, and administrative expenses			
Compensation expense	3,647	4,142	4,050
Other expense	2,421	3,123	2,044
Related party expense	399	452	534
Research and development expenses	3,444	3,444	3,512
	9,911	11,161	10,140
Income from operations	90,254	46,092	51,615
Interest and dividend income	5,875	4,776	3,495
Interest expense	(24)	(27)	(184)
Gain/(loss) on marketable securities	1,646	3,927	(1,889)
Other income/(expense)	(400)	112	(262)
	7,097	8,788	1,160
Income before income taxes	97,351	54,880	52,775
Provision for income taxes	23,317	20,576	18,266
Net income	$74,034	$34,304	$34,509
Earnings per common share			
Basic	$1.71	$0.83	$0.85
Diluted	$1.71	$0.83	$0.84
Weighted average shares outstanding			
Basic	43,237,513	41,366,860	40,708,552
Diluted	43,276,931	41,507,660	40,886,693

<u>**Comprehensive income**</u>	**2013**	**2012**	**2011**
Net income	$74,034	$34,304	$34,509
Other comprehensive income – unrealized gains on marketable securities, net of tax of $3,018 in 2013, $495 in 2012, and $797 in 2011	4,839	794	1,278

Comprehensive income	$78,873	$35,098	$35,787

The accompanying notes are an integral part of these financial statements.

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FutureFuel Corp.

Consolidated Statements of Cash Flows

For the Years Ended December 31, 2013, 2012, and 2011

(Dollars in thousands)

	2013	**2012**	**2011**
Cash flows provided by operating activities			
Net income	$74,034	$34,304	$34,509
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	10,316	10,454	9,098
(Benefit from)/provision for deferred income taxes	(1,972)	1,827	2,846
Change in fair value of derivative instruments	(617)	(1,506)	617
Other than temporary impairment of marketable securities	336	-	2,710
Impairment of fixed assets	18,102	-	466
Gain on sale of investments	(1,982)	(3,927)	(590)
Losses on disposals of fixed assets	261	63	262
Stock based compensation	-	281	502
Noncash interest expense	24	24	21
Changes in operating assets and liabilities:			
Accounts receivable	(5,838)		