SOUTHSIDE BANCSHARES INC
Form 10-Q
May 09, 2012

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 March 31, 2012

OR

o 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 0-12247

SOUTHSIDE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

TEXAS (State or other jurisdiction of incorporation or organization)	75-1848732 (I.R.S. Employer Identification No.)
1201 S. Beckham, Tyler, Texas (Address of principal executive offices)	75701 (Zip Code)

903-531-7111
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of shares of the issuer's common stock, par value $1.25, outstanding as of April 27, 2012 was 17,335,587 shares.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except share amounts)

ASSETS	March 31, 2012	December 31, 2011
Cash and due from banks	$42,997	$ 40,989
Interest earning deposits	3,211	2,249
Total cash and cash equivalents	46,208	43,238
Investment securities:		
Available for sale, at estimated fair value	291,928	282,956
Held to maturity, at amortized cost	1,010	1,496
Mortgage-backed and related securities:		
Available for sale, at estimated fair value	1,133,701	716,126
Securities carried at fair value through income	–	647,759
Held to maturity, at amortized cost	349,248	365,631
FHLB stock, at cost	32,407	33,869
Other investments, at cost	2,064	2,064
Loans held for sale	1,902	3,552
Loans:		
Loans	1,140,893	1,087,230
Less: allowance for loan losses	(20,074)	(18,540)
Net Loans	1,120,819	1,068,690
Premises and equipment, net	50,381	50,595
Goodwill	22,034	22,034
Other intangible assets, net	467	522
Interest receivable	13,935	19,426
Deferred tax asset	2,953	–
Unsettled trades to sell securities	104,065	–
Other assets	44,322	45,859
TOTAL ASSETS	$3,217,444	$ 3,303,817
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$558,196	$ 505,594
Interest bearing	1,752,256	1,816,077
Total deposits	2,310,452	2,321,671
Short-term obligations:		
Federal funds purchased and repurchase agreements	1,926	2,945
FHLB advances	171,864	361,811
Other obligations	219	219
Total short-term obligations	174,009	364,975
Long-term obligations:		
FHLB advances	281,618	260,724
Long-term debt	60,311	60,311
Total long-term obligations	341,929	321,035
Deferred tax liability	–	3,458

Unsettled trades to purchase securities	96,171	1,196
Other liabilities	35,004	32,555
TOTAL LIABILITIES	2,957,565	3,044,890
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 10)		
Shareholders' equity:		
Common stock – ($1.25 par, 40,000,000 shares authorized, 19,359,425 shares issued in 2012 (including 827,828 shares declared on March 29, 2012 as a stock dividend) and 18,517,101 shares issued in 2011)	24,199	23,146
Paid-in capital	193,553	176,791
Retained earnings	62,339	72,646
Treasury stock (2,023,838 shares at cost)	(28,377)	(28,377)
Accumulated other comprehensive income	8,165	14,721
TOTAL SHAREHOLDERS' EQUITY	259,879	258,927
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,217,444	$ 3,303,817

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands, except per share data)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Interest income		
Loans	$16,770	$17,271
Investment securities – taxable	31	18
Investment securities – tax exempt	2,667	3,229
Mortgage-backed and related securities	12,163	11,297
FHLB stock and other investments	79	80
Other interest earning assets	6	10
Total interest income	31,716	31,905
Interest expense		
Deposits	3,395	4,036
Short-term obligations	1,592	1,729
Long-term obligations	2,733	3,881
Total interest expense	7,720	9,646
Net interest income	23,996	22,259
Provision for loan losses	3,052	2,138
Net interest income after provision for loan losses	20,944	20,121
Noninterest income		
Deposit services	3,748	3,879
Gain on sale of securities available for sale	5,972	1,551
(Loss) gain on sale of securities carried at fair value through income	(485)	254
Total other-than-temporary impairment losses	–	–
Portion of loss recognized in other comprehensive income (before taxes)	(141)	–
Net impairment losses recognized in earnings	(141)	–
Fair value gain – securities	–	1,627
FHLB advance option impairment charges	(472)	–
Gain on sale of loans	131	283
Trust income	677	651
Bank owned life insurance income	266	286
Other	1,111	1,105
Total noninterest income	10,807	9,636
Noninterest expense		
Salaries and employee benefits	11,833	11,691
Occupancy expense	1,758	1,721
Equipment expense	510	493
Advertising, travel & entertainment	604	553
ATM and debit card expense	279	215
Director fees	268	191
Supplies	159	224
Professional fees	551	555
Postage	175	179

Telephone and communications	406	337
FDIC Insurance	470	763
Other	1,509	1,810
Total noninterest expense	18,522	18,732
Income before income tax expense	13,229	11,025
Provision for income tax expense	3,090	1,786
Net income	10,139	9,239
Less: Net income attributable to the noncontrolling interest	–	(865)
Net income attributable to Southside Bancshares, Inc.	$10,139	$8,374
Earnings per common share – basic	$0.58	$0.49
Earnings per common share – diluted	$0.58	$0.49
Dividends paid per common share	$0.18	$0.17

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net income	$10,139	$9,239
Other comprehensive (loss) income:		
Unrealized holding (losses) gains on available for sale securities during the period	(4,745)	6,154
Reclassification adjustment for gains on sales of available for sale securities included in net income	(5,972)	(1,551)
Reclassification of other-than-temporary impairment charges on available for sale securities included in net income	141	–
Amortization of net actuarial loss, included in net periodic benefit cost	499	366
Amortization of prior service credit included in net periodic benefit cost	(10)	(11)
Other comprehensive (loss) income	(10,087)	4,958
Income tax benefit (expense) related to other items of comprehensive income	3,531	(1,735)
Other comprehensive income (loss), net of tax	(6,556)	3,223
Comprehensive income	$3,583	$12,462

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)
(in thousands, except share amounts)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accu-mulated-Other Compre-hensive Income (Loss)	Noncon-trolling Interest	Total Equity
Balance at December 31, 2010	$22,075	$162,877	$64,179	$(28,377)	$(6,293)	$1,113	$215,574
Net Income			8,374			865	9,239
Other comprehensive income					3,223		3,223
Issuance of common stock (14,538 shares)	18	274					292
Tax benefit of incentive stock options		2					2
Capital distribution to noncontrolling interest shareholders						(115)	(115)
Dividends paid on common stock ($0.17 per share)			(2,658)				(2,658)
Stock dividend declared	988	15,121	(16,109)				–
Balance at March 31, 2011	$23,081	$178,274	$53,786	$(28,377)	$(3,070)	$1,863	$225,557
Balance at December 31, 2011	$23,146	$176,791	$72,646	$(28,377)	$14,721	$–	$258,927
Net Income			10,139				10,139
Other comprehensive loss					(6,556)		(6,556)
Issuance of common stock (14,496 shares)	18	282					300
Stock compensation		39					39

expense							
Dividends paid on common stock ($0.18 per share)			(2,970)				(2,970)
Stock dividend declared	1,035	16,441	(17,476)				–
Balance at March 31, 2012	$24,199	$193,553	$62,339	$(28,377)	$8,165	$–	$259,879

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED)
(in thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
OPERATING ACTIVITIES:		
Net income	$10,139	$9,239
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	870	806
Amortization of premium	10,366	8,708
Accretion of discount and loan fees	(1,129)	(1,171)
Provision for loan losses	3,052	2,138
Stock compensation expense	39	–
Deferred tax (benefit) expense	(2,880)	308
Loss (gain) on sale of securities carried at fair value through income	485	(254)
Gain on sale of securities available for sale	(5,972)	(1,551)
Net other-than-temporary impairment losses	141	–
Fair value gain – securities	–	(1,627)
FHLB advance option impairment charges	472	–
Loss on retirement of assets	–	90
Impairment on other real estate owned	–	130
Net change in:		
Interest receivable	5,491	2,818
Other assets	991	(2,299)
Interest payable	(289)	(409)
Other liabilities	3,227	1,356
Loans held for sale	1,650	3,918
Net cash provided by operating activities	26,653	22,200
INVESTING ACTIVITIES:		
Securities held to maturity:		
Purchases	–	(5,301)
Maturities, calls and principal repayments	15,365	12,554
Securities available for sale:		
Purchases	(618,587)	(252,881)
Sales	127,298	169,172
Maturities, calls and principal repayments	58,500	79,645
Securities carried at fair value through income:		
Purchases	(57,606)	(130,064)
Sales	664,224	12,983
Maturities, calls and principal repayments	24,872	3,812
Proceeds from redemption of FHLB stock	8,533	9,738
Purchases of FHLB stock and other investments	(7,071)	(4,242)
Net (increase) decrease in loans	(55,281)	10,529
Purchases of premises and equipment	(656)	(1,092)
Proceeds from sales of repossessed assets	1,002	1,517
Net cash provided by (used in) investing activities	160,593	(93,630)

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED) (continued)
(in thousands)

	Three Months Ended March 31, 2012	2011
FINANCING ACTIVITIES:		
Net increase in demand and savings accounts	71,978	44,367
Net (decrease) increase in certificates of deposit	(83,512)	26,827
Net decrease in federal funds purchased and repurchase agreements	(1,019)	(863)
Proceeds from FHLB advances	2,964,409	1,074,136
Repayment of FHLB advances	(3,133,462)	(1,100,011)
Net capital distributions to noncontrolling interest in consolidated entities	–	(115)
Tax benefit of incentive stock options	–	2
Proceeds from the issuance of common stock	300	292
Dividends paid	(2,970)	(2,658)
Net cash (used in) provided by financing activities	(184,276)	41,977
Net increase (decrease) in cash and cash equivalents	2,970	(29,453)
Cash and cash equivalents at beginning of period	43,238	79,073
Cash and cash equivalents at end of period	$46,208	$49,620
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
Interest paid	$8,009	$10,055
Income taxes paid	$2,000	$–
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Acquisition of other repossessed assets and real estate through foreclosure	$872	$1,576
Adjustment to pension liability	$(489)	$(355)
Declaration of 5% stock dividend	$17,476	$16,109
Unsettled trades to purchase securities	$(96,171)	$(52,044)
Unsettled trades to sell securities	$104,065	$–

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

In this report, the words "the Company," "we," "us," and "our" refer to the combined entities of Southside Bancshares, Inc and its subsidiaries. The words "Southside" and "Southside Bancshares" refer to Southside Bancshares, Inc. The words "Southside Bank" and "the Bank" refer to Southside Bank (which, subsequent to the internal merger of Fort Worth National Bank ("FWNB") with and into Southside Bank, includes FWNB). "FWBS" refers to Fort Worth Bancshares, Inc., a bank holding company acquired by Southside of which FWNB was a wholly-owned subsidiary. "SFG" refers to SFG Finance, LLC (formerly Southside Financial Group, LLC) which is a wholly-owned subsidiary of the Bank as of July 15, 2011. "SSI" refers to Southside Securities, Inc., which is a wholly-owned subsidiary of Southside Bancshares, Inc.

The consolidated balance sheet as of March 31, 2012, and the related consolidated statements of income, comprehensive income, equity and cash flows and notes to the financial statements for the three month period ended March 31, 2012 and 2011 are unaudited; in the opinion of management, all adjustments necessary for a fair statement of such financial statements have been included. Such adjustments consisted only of normal recurring items. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the use of management's estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2011. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends. For a description of our significant accounting and reporting policies, refer to Note 1 of the Notes to Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2011.

Accounting Standards

ASU No. 2011-02, "Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 became effective for us on July 1, 2011, and applies retrospectively to restructurings occurring on or after January 1, 2011. See "Note 5 – Loans and Allowance for Probable Loan Losses."

ASU No. 2011-03, "Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements." ASU 2011-03 is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 removes from the assessment of effective control (i) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance guidance related to that criterion. ASU 2011-03 became effective for us on January 1, 2012 and did not have a significant impact on our consolidated financial statements.

ASU 2011-04, “Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs.” ASU 2011-04 amends Topic 820, “Fair Value Measurements and Disclosures,” to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011, and did not have a significant impact on our consolidated financial statements. See “Note 9 - Fair Value Measurement.”

ASU 2011-05, “Comprehensive Income (Topic 220) – Presentation of Comprehensive Income.” ASU 2011-05 amends Topic 220, “Comprehensive Income,” to require that all nonowner changes in stockholders’ equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. ASU 2011-05 is effective for annual and interim periods beginning after December 15, 2011; however, certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12 “Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05,” as further discussed below. ASU 2011-05 did not have a significant impact on our consolidated financial statements. See “Consolidated Statements of Comprehensive Income” directly following our Consolidated Statements of Income in our consolidated financial statements.

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ASU 2011-08, “Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment.” ASU 2011-08 amends Topic 350, “Intangibles – Goodwill and Other,” to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and did not have a significant impact on our consolidated financial statements.

ASU 2011-11, “Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities.” ASU 2011-11 amends Topic 210, “Balance Sheet,” to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a significant impact on our consolidated financial statements.

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2. Earnings Per Share

Earnings per share attributable to Southside Bancshares, Inc. on a basic and diluted basis have been adjusted to give retroactive recognition to stock splits and stock dividends and is calculated as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2012	2011
Basic and Diluted Earnings:		
Net income – Southside Bancshares, Inc.	$10,139	$8,374
Basic weighted-average shares outstanding	17,324	17,247
Add: Stock options	9	5
Diluted weighted-average shares outstanding	17,333	17,252
Basic Earnings Per Share:		
Net Income - Southside Bancshares, Inc.	$0.58	$0.49
Diluted Earnings Per Share:		
Net Income - Southside Bancshares, Inc.	$0.58	$0.49

On March 29, 2012, our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 18, 2012, and payable on May 9, 2012.

During the second quarter of 2011, our board of directors approved equity grants in the form of stock options and restricted stock units. These equity grants were made pursuant to the shareholder-approved Southside Bancshares, Inc. 2009 Incentive Plan.

For the three month period ended March 31, 2012, there were approximately 11,000 antidilutive options. For the three months ended March 31, 2011, there were no antidilutive options.

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3. Comprehensive (Loss) Income

The components of other comprehensive (loss) income are as follows (in thousands):

	Three Months Ended March 31, 2012		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$(4,745)	$1,661	$(3,084)
Less: reclassification adjustment for gains included in net income	5,972	(2,090)	3,882
Less: reclassification of other-than-temporary impairment charges on AFS securities included in net income	(141)	49	(92)
Net unrealized losses on securities	(10,576)	3,702	(6,874)
Change in pension plans	489	(171)	318
Other comprehensive loss	$(10,087)	$3,531	$(6,556)

	Three Months Ended March 31, 2011		
	Before-Tax Amount	Tax Expense	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during period	$6,154	$(2,154)	$4,000
Less: reclassification adjustment for gains included in net income	1,551	(543)	1,008
Net unrealized gains on securities	4,603	(1,611)	2,992
Change in pension plans	355	(124)	231
Other comprehensive income	$4,958	$(1,735)	$3,223

4. Securities

The amortized cost and estimated fair value of investment and mortgage-backed securities as of March 31, 2012 and December 31, 2011, are reflected in the tables below (in thousands):

	March 31, 2012				
		Gross	Gross		
	Amortized	Unrealized	Unrealized Losses		Estimated
AVAILABLE FOR SALE:	Cost	Gains	OTTI	Other	Fair Value
Investment Securities:					
State and Political Subdivisions	$267,569	$22,929	$–	$493	$290,005
Other Stocks and Bonds	4,015	34	2,126	–	1,923
Mortgage-backed Securities:					
U.S. Government Agencies	135,181	4,504	–	265	139,420
Government-Sponsored Enterprises	974,262	20,814	–	795	994,281
Total	$1,381,027	$48,281	$2,126	$1,553	$1,425,629

	March 31, 2012				
		Gross	Gross		
	Amortized	Unrealized	Unrealized Losses		Estimated
HELD TO MATURITY:	Cost	Gains	OTTI	Other	Fair Value
Investment Securities:					
State and Political Subdivisions	$1,010	$133	$–	$–	$1,143

Mortgage-backed Securities:					
U.S. Government Agencies	22,436	1,322	–	–	23,758
Government-Sponsored Enterprises	326,812	12,886	–	–	339,698
Total	$350,258	$14,341	$–	$–	$364,599

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	December 31, 2011				
		Gross	Gross		
	Amortized	Unrealized	Unrealized Losses		Estimated
AVAILABLE FOR SALE:	Cost	Gains	OTTI	Other	Fair Value
Investment Securities:					
State and Political Subdivisions	$251,281	$31,221	$–	$45	$282,457
Other Stocks and Bonds	2,925	–	2,426	–	499
Mortgage-backed Securities:					
U.S. Government Agencies	99,974	7,158	–	80	107,052
Government-Sponsored Enterprises	589,687	20,127	–	740	609,074
Total	$943,867	$58,506	$2,426	$865	$999,082

	December 31, 2011				
		Gross	Gross		
	Amortized	Unrealized	Unrealized Losses		Estimated
HELD TO MATURITY:	Cost	Gains	OTTI	Other	Fair Value
Investment Securities:					
State and Political Subdivisions	$1,010	$196	$–	$–	$1,206
Other Stocks and Bonds	486	15	–	–	501
Mortgage-backed Securities:					
U.S. Government Agencies	22,999	1,159	–	43	24,115
Government-Sponsored Enterprises	342,632	14,848	–	11	357,469
Total	$367,127	$16,218	$–	$54	$383,291

Securities carried at fair value through income were as follows (in thousands):

	March 31,	December 31,	
	2012	2011	2010
Mortgage-backed Securities:			
U.S. Government Agencies	$–	$30,413	$5,392
Government-Sponsored Enterprises	–	617,346	66,784
Total	$–	$647,759	$72,176

Net gains and losses on securities carried at fair value through income were as follows (in thousands):

	Three Months Ended March 31,	
	2012	2011
Net (loss) gain on sales transactions	$ (485)	$ 254
Net mark-to-market gains (losses)	–	1,627
Net (loss) gain on securities carried at fair value through income	$ (485)	$ 1,881

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The following table represents the unrealized loss on securities for the three months ended March 31, 2012 and year ended December 31, 2011 (in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
As of March 31, 2012:						
Available for Sale						
State and Political Subdivisions	$27,995	$493	$–	$–	$27,995	$493
Other Stocks and Bonds	–	–	658	2,126	658	2,126
Mortgage-Backed Securities	226,272	1,016	4,107	44	230,379	1,060
Total	$254,267	$1,509	$4,765	$2,170	$259,032	$3,679
As of December 31, 2011:						
Available for Sale						
State and Political Subdivisions	$1,668	$42	$307	$3	$1,975	$45
Other Stocks and Bonds	–	–	499	2,426	499	2,426
Mortgage-Backed Securities	148,171	754	5,322	66	153,493	820
Total	$149,839	$796	$6,128	$2,495	$155,967	$3,291
Held to Maturity						
Mortgage-Backed Securities	$8,918	$54	$–	$–	$8,918	$54
Total	$8,918	$54	$–	$–	$8,918	$54

When it is determined that a decline in fair value of HTM and AFS securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and the noncredit portion to other comprehensive income. In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. Additionally, we do not currently intend to sell the securities and it is not more likely than not that we will be required to sell the security before the anticipated recovery of its amortized cost basis.

The turmoil in the capital markets had a significant impact on our estimate of fair value for certain of our securities. We believe the fair values are reflective of illiquidity and credit impairment. At March 31, 2012, we have in AFS Other Stocks and Bonds, $2.8 million amortized cost basis in pooled trust preferred securities ("TRUPs"). Those securities are structured products with cash flows dependent upon securities issued by U.S. financial institutions, including banks and insurance companies. Our estimate of fair value at March 31, 2012 for the TRUPs is approximately $658,000 and reflects the market illiquidity. With the exception of the TRUPs, to the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and mortgage-backed securities portfolio at March 31, 2012 with an other-than-temporary impairment.

Given the facts and circumstances associated with the TRUPs we performed detailed cash flow modeling for each TRUP using an industry-accepted cash flow model. Prior to loading the required assumptions into the model we reviewed the financial condition of each of the underlying issuing banks within the TRUP collateral pool that had not deferred or defaulted as of March 31, 2012. Management's best estimate of a deferral assumption was assigned to each issuing bank based on the category in which it fell. Our analysis of the underlying cash flows contemplated various default, deferral and recovery scenarios to arrive at our best estimate of cash flows. Based on that detailed analysis, we have concluded that the other-than-temporary impairment, which captures the credit component, was estimated at $3.2 million at March 31, 2012 and $3.1 million at March 31, 2011. The noncredit charge to other comprehensive income was estimated at $2.1 million at March 31, 2012 and $2.4 million at December 31, 2011. Therefore, the carrying amount of the TRUPs was written down with $75,000 and $3.0 million recognized in earnings for the years ended December 31, 2010 and 2009, respectively. There was an additional write-down of the TRUPs recognized in earnings for the three months ended March 31, 2012 in the amount of $141,400. The cash flow model assumptions represent management's best estimate and consider a variety of qualitative factors, which include, among others, the credit rating downgrades, the severity and duration of the mark-to-market loss, and the structural nuances of each TRUP. Management believes that the detailed review of the collateral and cash flow modeling support the conclusion that the TRUPs had an other-than-temporary impairment at March 31, 2012. We will continue to update our assumptions and the resulting analysis each reporting period to reflect changing market conditions. Additionally, we do not currently intend to sell the TRUPs and it is not more likely than not that we will be required to sell the TRUPs before the anticipated recovery of their amortized cost basis.

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The table below provides more detail on the TRUPs at March 31, 2012 (dollars in thousands).

TRUP	Par	Credit Loss	Amortized Cost	Fair Value	Tranche	Credit Rating
1	$ 2,000	$ 1,216	$ 784	$ 138	C1	Ca
2	2,000	550	1,450	344	B1	C
3	2,000	1,450	550	176	B2	C
	$ 6,000	$ 3,216	$ 2,784	$ 658		

The following table presents the impairment related to loss, which is recognized in earnings, and the impairment activity related to all other factors, which are recognized in other comprehensive income (in thousands).

	Three Months Ended March 31, 2012		
	Impairment Related to Credit Loss	Impairment Related to All Other Factors	Total Impairment
Balance, beginning of the period	$3,075	$ 2,694	$5,769
Charges on securities for which other-than-temporary impairment charges were not previously recognized	–	–	–
Additional charges on securities for which other-than-temporary impairment charges were previously recognized	141	(141)	–
Balance, end of the period	$3,216	$ 2,553	$5,769

Interest income recognized on securities for the periods presented (in thousands):

	Three Months Ended March 31,	
	2012	2011
U.S. Treasury	$ –	$ 1
State and Political Subdivisions	2,674	3,237
Other Stocks and Bonds	24	9
Mortgage-backed Securities	12,163	11,297
Total interest income on securities	$ 14,861	$ 14,544

There were no securities transferred from AFS to HTM during the three months ended March 31, 2012 or 2011. There were no sales from the HTM portfolio during the three months ended March 31, 2012 or 2011. There were $350.3 million and $367.1 million of securities classified as HTM at March 31, 2012 and December 31, 2011, respectively.

Of the $6.0 million in net securities gains from the AFS portfolio for the three months ended March 31, 2012, there were $6.0 million in realized gains and approximately $3,000 in realized losses. Of the $1.6 million in net securities gains from the AFS portfolio for the three months ended March 31, 2011, there were $1.6 million in realized gains and $45,000 in realized losses.

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The amortized cost and fair value of securities at March 31, 2012, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are presented in total by category due to the fact that mortgage-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	March 31, 2012	
	Amortized Cost	Fair Value
Available for sale securities:	(in thousands)	
Investment Securities		
Due in one year or less	$ 2,245	$ 2,266
Due after one year through five years	8,906	9,267
Due after five years through ten years	36,440	38,645
Due after ten years	223,993	241,750
	271,584	291,928
Mortgage-backed securities	1,109,443	1,133,701
Total	$ 1,381,027	$ 1,425,629

	March 31, 2012	
	Amortized Cost	Fair Value
Held to maturity securities:	(in thousands)	
Investment Securities		
Due in one year or less	$ –	$ –
Due after one year through five years	–	–
Due after five years through ten years	–	–
Due after ten years	1,010	1,143
	1,010	1,143
Mortgage-backed securities	349,248	363,456
Total	$ 350,258	$ 364,599

Investment and mortgage-backed securities with book values of $831.5 million and $1.04 billion were pledged as of March 31, 2012 and December 31, 2011, respectively, to collateralize FHLB advances, repurchase agreements, public funds and trust deposits or for other purposes as required by law.

Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates its fair value and assessed for other-than-temporary impairment. These securities have no maturity date.

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5. LOANS AND ALLOWANCE FOR PROBABLE LOAN LOSSES

Loans in the accompanying consolidated balance sheets are classified as follows (in thousands):

	March 31, 2012	December 31, 2011
Real Estate Loans:		
Construction	$111,924	$ 111,361
1-4 family residential	291,020	247,479
Other	208,536	206,519
Commercial loans	145,730	143,552
Municipal loans	206,230	207,261
Loans to individuals	177,453	171,058
Total loans	1,140,893	1,087,230
Less: Allowance for loan losses	20,074	18,540
Net loans	$1,120,819	$ 1,068,690

Allowance for Loan Losses

The allowance for loan losses is based on the most current review of the loan portfolio and is validated by multiple processes. First, the bank utilizes historical data to establish general reserve amounts for each class of loans. While we track several years of data, we primarily review one year data because we have found that longer periods will not respond quickly enough to market conditions. Second, our lenders have the primary responsibility for identifying problem loans and estimating necessary reserves based on customer financial stress and underlying collateral. These recommendations are reviewed by the Senior lender, the Special Assets department, and the Loan Review department and are reviewed by the President. Third, the Loan Review department does independent reviews of the portfolio on an annual basis. The Loan Review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of metrics that takes into consideration the size of the loan, the type of credit extended, the seasoning of the loan along with the performance of the loan. The loan review scope as it relates to size, focuses more on larger dollar loan relationships, typically, for example, aggregate debt of $500,000 or greater. The Loan Review officer also tracks specific reserves for loans by type compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge off to determine the efficiency of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to allocate the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $50,000 or more is updated on a quarterly basis in order to properly allocate necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

For loans to individuals, the methodology associated with determining the appropriate allowance for losses on loans primarily consists of an evaluation of individual payment histories, remaining term to maturity and underlying collateral support.

Industry experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or entire charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit of the borrower and the ability of the borrower to make payments on the loan. Our determination of the adequacy of allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, the views of the bank regulators (who have the authority to require additional allowances), and geographic and industry loan concentration.

Consumer loans at SFG are reserved for based on general estimates of loss at the time of purchase for current loans. SFG loans experiencing past due status or extension of maturity characteristics are reserved at significantly higher levels based on the circumstances associated with each specific loan. In general, the reserves for SFG are calculated based on the past due status of the loan. For reserve purposes, the portfolio has been segregated by past due status and by the remaining term variance from the original contract. During repayment, loans that pay late will take longer to pay out than the original contract. Additionally, some loans may be granted extensions for extenuating payment circumstances. The remaining term extensions increase the risk of collateral deterioration and, accordingly, reserves are increased to recognize this risk.

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For loans purchased after August 1, 2010, additional reserve methods have been added. New pools purchased are reserved at their estimated annual loss. Thereafter, the reserve is adjusted based on the actual performance versus projected performance. Additionally, beginning with the fourth quarter of 2010, data mining measures were further enhanced to track migration within risk tranches. Reserves are adjusted quarterly to match the migration metrics.

Credit Quality Indicators

We categorize loans into risk categories on an ongoing basis, based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We use the following definitions for risk ratings:

- Satisfactory (Rating 1 – 4) – This rating is assigned to all satisfactory loans. This category, by definition, should consist of completely acceptable credit. Credit and collateral exceptions should not be present, although their presence would not necessarily prohibit a loan from being rated Satisfactory, if deficiencies are in process of correction. These loans will not be included in the Watch List.

- Satisfactory (Rating 5) – Special Treatment Required – (Pass Watch) – These loans require some degree of special treatment, but not due to credit quality. This category does not include loans specially mentioned or adversely classified by the Loan Review Officer or regulatory authorities; however, particular attention must be accorded such credits due to characteristics such as:

  - A lack of, or abnormally extended payment program;
  - A heavy degree of concentration of collateral without sufficient margin;
  - A vulnerability to competition through lesser or extensive financial leverage; and
- A dependence on a single, or few customers, or sources of supply and materials without suitable substitutes or alternatives.

- Special Mention (Rating 6) – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

- Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

- Doubtful (Rating 8) – Loans classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation, in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

- Loss (Rating 9) – Loans classified as Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

Loans not meeting risk ratings five through nine are reserved for as a group of similar type pass rated credits and included in the general portion of the allowance for loan losses.

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The general portion of the loan loss allowance is reflective of historical charge-off levels for similar loans adjusted for changes in current conditions and other relevant factors. These factors are likely to cause estimated losses to differ from historical loss experience and include:

- Changes in lending policies or procedures, including underwriting, collection, charge-off, and recovery procedures;
- Changes in local, regional and national economic and business conditions including entry into new markets;
- Changes in the volume or type of credit extended;
- Changes in the experience, ability, and depth of lending management;
- Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans;
- Changes in loan review or Board oversight; and
- Changes in the level of concentrations of credit.

The following table details activity in the Allowance for Loan Losses by portfolio segment for the periods presented (in thousands):

	Three Months Ended March 31, 2012							
	Construction	Real Estate 1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Balance at beginning of period	$2,620	$ 1,957	$3,051	$ 2,877	$ 619	$ 6,244	$ 1,172	$18,540
Provision (reversal) for loan losses	49	339	12	355	(11)	2,311	(3)	3,052
Loans charged off	(8)	(11)	–	(88)	–	(2,123)	–	(2,230)
Recoveries of loans charged off	21	5	2	198	–	486	–	712
Balance at end of period	$2,682	$ 2,290	$3,065	$ 3,342	$ 608	$ 6,918	$ 1,169	$20,074

	Three Months Ended March 31, 2011							
	Construction	Real Estate 1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Balance at beginning of period	$2,585	$ 1,988	$3,354	$ 3,746	$ 607	$ 7,978	$ 453	$20,711
Provision (reversal) for loan losses	247	74	(148)	190	(2)	1,634	143	2,138
Loans charged off	–	(319)	(80)	(550)	–	(3,099)	–	(4,048)
Recoveries of loans charged off	–	65	195	111	–	608	–	979
Balance at end of period	$2,832	$ 1,808	$3,321	$ 3,497	$ 605	$ 7,121	$ 596	$19,780

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The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as described in the allowance for loan losses methodology discussion for the periods presented. (in thousands):

	As of March 31, 2012							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Ending balance – individually evaluated for impairment	$931	$ 908	$510	$ 1,551	$ 102	$ 455	$ –	$4,457
Ending balance – collectively evaluated for impairment	1,751	1,382	2,555	1,791	506	6,463	1,169	15,617
Balance at end of period	$2,682	$ 2,290	$3,065	$ 3,342	$ 608	$ 6,918	$ 1,169	$20,074

	As of December 31, 2011							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Ending balance – individually evaluated for impairment	$888	$ 788	$511	$ 1,108	$ 110	$ 347	$ –	$3,752
Ending balance – collectively evaluated for impairment	1,732	1,169	2,540	1,769	509	5,897	1,172	14,788
Balance at end of period	$2,620	$ 1,957	$3,051	$ 2,877	$ 619	$ 6,244	$ 1,172	$18,540

The following table details activity of the Reserve for Unfunded Loan Commitments for the periods presented (in thousands):

	Three Months Ended March 31,	
	2012	2011
Reserve For Unfunded Loan Commitments:		
Balance at beginning of year	$ 26	$ 30
Provision for losses on unfunded loan commitments	–	–
Balance at end of year	$ 26	$ 30

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The following table sets forth the balance in the recorded investment in loans by portfolio segment based on impairment method as described in the allowance for loan losses methodology discussion for the periods presented (in thousands):

March 31, 2012	Construction	Real Estate 1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$5,772	$13,043	$10,122	$6,315	$620	$1,488	$37,360
Loans collectively evaluated for impairment	106,152	277,977	198,414	139,415	205,610	175,965	1,103,533
Total ending loans balance	$111,924	$291,020	$208,536	$145,730	$206,230	$177,453	$1,140,893

December 31, 2011	Construction	Real Estate 1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$6,274	$12,453	$9,394	$5,986	$651	$1,320	$36,078
Loans collectively evaluated for impairment	105,087	235,026	197,125	137,566	206,610	169,738	1,051,152
Total ending loans balance	$111,361	$247,479	$206,519	$143,552	$207,261	$171,058	$1,087,230

The following table sets forth loans by credit quality indicator for the periods presented (in thousands):

March 31, 2012	Pass	Pass Watch	Special Mention	Substandard	Doubtful	Loss	Total
Real Estate Loans:							
Construction	$106,152	$95	$20	$5,456	$201	$–	$111,924
1-4 Family residential	277,977	1,749	3,945	6,149	1,200	–	291,020
Other	198,414	3,491	3,025	3,478	128	–	208,536
Commercial loans	139,414	866	–	4,689	691	70	145,730
Municipal loans	205,610	232	–	388	–	–	206,230
Loans to individuals	175,966	72	–	884	498	33	177,453
Total	$1,103,533	$6,505	$6,990	$21,044	$2,718	$103	$1,140,893

December 31, 2011	Pass	Pass Watch	Special Mention	Substandard	Doubtful	Loss	Total