GREAT SOUTHERN BANCORP INC
Form 10-Q
November 10, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

/X/ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the Quarterly Period ended September 30, 2008

Commission File Number 0-18082

GREAT SOUTHERN BANCORP, INC.
(Exact name of registrant as specified in its charter)

Maryland	43-1524856
(State of Incorporation)	(IRS Employer Identification Number)

1451 E. Battlefield, Springfield, Missouri	65804
(Address of Principal Executive Offices)	(Zip Code)

(417) 887-4400
(Registrant's telephone number, including area code)

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

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

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

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

The number of shares outstanding of each of the registrant's classes of common stock: 13,380,969 shares of common stock, par value $.01, outstanding at November 7, 2008.

PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.

GREAT SOUTHERN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(In thousands, except number of shares)

	SEPTEMBER 30, 2008 (Unaudited)	DECEMBER 31, 2007
ASSETS		
Cash	$ 56,020	$ 79,552
Interest-bearing deposits in other financial institutions	67,008	973
Cash and cash equivalents	123,028	80,525
Available-for-sale securities	505,715	425,028
Held-to-maturity securities (fair value $1,443 – September 2008; $1,508 - December 2007)	1,360	1,420
Mortgage loans held for sale	5,184	6,717
Loans receivable, net of allowance for loan losses of $29,379 – September 2008; $25,459 - December 2007	1,766,583	1,813,394
Interest receivable	12,103	15,441
Prepaid expenses and other assets	17,666	14,904
Foreclosed assets held for sale, net	32,810	20,399
Premises and equipment, net	29,954	28,033
Goodwill and other intangible assets	1,737	1,909
Investment in Federal Home Loan Bank stock	8,448	13,557
Refundable income taxes	7,252	1,701
Deferred income taxes	16,072	8,704
Total Assets	$ 2,527,912	$ 2,431,732
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$ 1,854,474	$ 1,763,146
Securities sold under reverse repurchase agreements with customers	229,274	143,721
Federal Home Loan Bank advances	122,847	213,867
Structured repurchase agreements	50,000	--
Short-term borrowings	52,519	73,000
Subordinated debentures issued to capital trust	30,929	30,929
Accrued interest payable	8,882	6,149
Advances from borrowers for taxes and insurance	1,232	378
Accounts payable and accrued expenses	8,971	10,671
Total Liabilities	2,359,128	2,241,861
Stockholders' Equity:		
Capital stock		
Serial preferred stock, $.01 par value; authorized 1,000,000 shares; none issued	--	--

Common stock, $.01 par value; authorized 20,000,000 shares; issued and outstanding September 2008 - 13,380,969 shares; December 2007 - 13,400,197 shares		134		134
Additional paid-in capital		19,693		19,342
Retained earnings		155,329		170,933
Accumulated other comprehensive income (loss)		(6,372)		(538)
Total Stockholders' Equity		168,784		189,871
Total Liabilities and Stockholders' Equity	$	2,527,912	$	2,431,732

See Notes to Consolidated Financial Statements

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GREAT SOUTHERN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2008	2007	2008	2007
INTEREST INCOME	(Unaudited)		(Unaudited)	
Loans	$ 28,992	$ 36,636	$ 91,393	$ 107,477
Investment securities and other	6,032	5,340	17,635	15,661
TOTAL INTEREST INCOME	35,024	41,976	109,028	123,138
INTEREST EXPENSE				
Deposits	13,708	19,867	45,471	57,489
Federal Home Loan Bank advances	1,140	1,738	3,864	5,065
Short-term borrowings and repurchase agreements	1,473	1,917	4,255	5,576
Subordinated debentures issued to capital trust	336	522	1,097	1,402
TOTAL INTEREST EXPENSE	16,657	24,044	54,687	69,532
NET INTEREST INCOME	18,367	17,932	54,341	53,606
PROVISION FOR LOAN LOSSES	4,500	1,350	47,200	4,125
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	13,867	16,582	7,141	49,481
NON-INTEREST INCOME				
Commissions	1,964	2,435	7,036	7,665
Service charges and ATM fees	4,067	3,817	11,603	11,270
Net realized gains on sales of loans	369	247	1,127	682
Net realized gains (losses) on sales and impairments of available-for-sale securities	(5,293)	4	(5,286)	4
Net gain on sales of fixed assets	9	11	175	35
Late charges and fees on loans	259	370	632	752
Change in interest rate swap fair value net of change in hedged deposit fair value	32	157	5,287	843
Other income	382	569	1,262	1,252
TOTAL NON-INTEREST INCOME	1,789	7,610	21,836	22,503
NON-INTEREST EXPENSE				
Salaries and employee benefits	7,561	7,744	23,807	22,373
Net occupancy and equipment expense	2,027	1,971	6,212	5,844
Postage	558	552	1,690	1,670
Insurance	542	537	1,662	984
Advertising	247	355	866	1,063
Office supplies and printing	209	187	654	659
Telephone	320	339	1,052	1,006
Legal, audit and other professional fees	515	285	1,236	867
Expense on foreclosed assets	1,868	125	2,484	275
Other operating expenses	803	1,225	2,661	3,239

TOTAL NON-INTEREST EXPENSE		14,650		13,320		42,324		37,980
INCOME (LOSS) BEFORE INCOME TAXES		1,006		10,872		(13,347)		34,004
PROVISION (CREDIT) FOR INCOME TAXES		182		3,555		(5,350)		11,144
NET INCOME (LOSS)	$	824	$	7,317	$	(7,997)	$	22,860
BASIC EARNINGS (LOSS) PER COMMON SHARE	$	.06	$	.54	$	(.60)	$	1.68
DILUTED EARNINGS (LOSS) PER COMMON SHARE	$	.06	$	.54	$	(.60)	$	1.67
DIVIDENDS DECLARED PER COMMON SHARE	$	.18	$	.17	$	.54	$	.50

See Notes to Consolidated Financial Statements

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GREAT SOUTHERN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	NINE MONTHS ENDED SEPTEMBER 30, 2008	2007
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (7,997)	$ 22,860
Proceeds from sales of loans held for sale	75,665	52,498
Originations of loans held for sale	(68,236)	(48,636)
Items not requiring (providing) cash:		
Depreciation	1,833	1,999
Amortization	293	303
Provision for loan losses	47,200	4,125
Net gains on loan sales	(1,127)	(682)
Net (gains) losses on sale or impairment of available-for-sale investment securities	5,286	(4)
Net gains on sale of premises and equipment	(175)	(35)
(Gain) loss on sale of foreclosed assets	1,235	(133)
Amortization of deferred income, premiums and discounts	(1,647)	(3,195)
Change in interest rate swap fair value net of change in hedged deposit fair value	(5,287)	(843)
Deferred income taxes	(4,227)	2,040
Changes in:		
Interest receivable	3,338	(2,287)
Prepaid expenses and other assets	(6,177)	1,046
Accounts payable and accrued expenses	2,852	(9,714)
Income taxes refundable/payable	(5,551)	(549)
Net cash provided by operating activities	37,278	18,793
CASH FLOWS FROM INVESTING ACTIVITIES		
Net increase in loans	(21,549)	(113,765)
Purchase of loans	(3,506)	(4,141)
Proceeds from sale of student loans	634	2,455
Purchase of additional business units	--	(730)
Purchase of premises and equipment	(3,992)	(2,642)
Proceeds from sale of premises and equipment	413	65
Proceeds from sale of foreclosed assets	8,065	1,810
Capitalized costs on foreclosed assets	(394)	(94)
Proceeds from sales of available-for-sale investment securities	85,242	1,664
Proceeds from maturing available-for-sale investment securities	21,000	391,335
Proceeds from maturing held-to-maturity investment securities	60	50
Proceeds from called investment securities	120,500	6,850
Principal reductions on mortgage-backed securities	48,937	56,805
Purchase of available-for-sale securities	(371,034)	(511,729)
(Purchase) redemption of Federal Home Loan Bank stock	5,109	(1,062)
Net cash used in investing activities	(110,515)	(173,129)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in certificates of deposit	205,078	(13,331)

Net increase (decrease) in checking and savings deposits		(106,985)		90,167
Proceeds from Federal Home Loan Bank advances		503,000		749,000
Repayments of Federal Home Loan Bank advances		(594,020)		(734,097)
Net increase in short-term borrowings and structured repo		115,072		55,732
Advances from borrowers for taxes and insurance		854		864
Proceeds from issuance of trust preferred debentures		--		5,155
Stock repurchase		(408)		(6,036)
Dividends paid		(7,227)		(6,685)
Stock options exercised		376		1,353
Net cash provided by financing activities		115,740		142,122
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		42,503		(12,214)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		80,525		133,150
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	123,028	$	120,936

See Notes to Consolidated Financial Statements

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

NOTE 1: BASIS OF PRESENTATION

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

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

NOTE 2: OPERATING SEGMENTS

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

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

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

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

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

NOTE 3: COMPREHENSIVE INCOME

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

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

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

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NOTE 4: RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

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

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States (the GAAP hierarchy). The FASB concluded that the GAAP hierarchy should reside in the accounting literature established by the FASB and is issuing this Statement to achieve that result. SFAS No. 162 is effective sixty days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411. The adoption of this standard is not anticipated to have a material effect on the Company's financial position or results of operations.

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

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

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

NOTE 5: DERIVATIVE FINANCIAL INSTRUMENTS

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

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

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

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

The Company uses derivatives to modify the repricing characteristics of certain assets and liabilities so that changes in interest rates do not have a significant adverse effect on net interest income and cash flows and to better match the repricing profile of its interest-sensitive assets and liabilities. As a result of interest rate fluctuations, certain interest-sensitive assets and liabilities will gain or lose market value. In an effective fair value hedging strategy, the effect of this change in value will generally be offset by a corresponding change in value on the derivatives linked to the hedged assets and liabilities.

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

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

NOTE 6: STOCKHOLDERS' EQUITY

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

NOTE 7: INVESTMENT SECURITIES

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

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

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