CITY HOLDING CO
Form 10-Q
November 05, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

T QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended September 30, 2008

OR

£ TRANSITION REPORT PURSANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Transition Period From ____________To_____________.

Commission File number 0-11733

CITY HOLDING COMPANY
(Exact name of registrant as specified in its charter)

West Virginia (State or other jurisdiction of incorporation or organization)	55-0619957 (I.R.S. Employer Identification No.)
25 Gatewater Road Charleston, West Virginia (Address of principal executive offices)	25313 (Zip Code)

(304) 769-1100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant has (1) 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 T No £

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

Large accelerated filer £ Accelerated filer T

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 T

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

Common stock, $2.50 Par Value – 16,182,644 shares as of November 4, 2008.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management's Discussion and Analysis of Financial Condition and Result of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company's actual results differing from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to: (1) the Company may incur additional provision for loan losses due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company may experience increases in the default rates or decreased prepayments on previously securitized loans that would result in impairment losses or lower the yield on such loans; (4) the Company may continue to benefit from strong recovery efforts on previously securitized loans resulting in improved yields on this asset; (5) the Company could have adverse legal actions of a material nature; (6) the Company may face competitive loss of customers; (7) the Company may be unable to manage its expense levels; (8) the Company may have difficulty retaining key employees; (9) changes in the interest rate environment may have results on the Company's operations materially different from those anticipated by the Company's market risk management functions; (10) changes in general economic conditions and increased competition could adversely affect the Company's operating results; (11) changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company's operating results; (12) the Company may experience difficulties growing loan and deposit balances; (13) the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations; and (14) the United States government's plan to purchase large amounts of illiquid, mortgage-backed and other securities from financial institutions may not be effective and/or it may not be available to us. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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City Holding Company and Subsidiaries

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PART I, ITEM 1 – FINANCIAL STATEMENTS
Consolidated Balance Sheets
City Holding Company and Subsidiaries
(in thousands)

	September 30 2008 (Unaudited)	December 31 2007 (Note A)
Assets		
Cash and due from banks	$ 52,206	$ 64,726
Interest-bearing deposits in depository institutions	4,045	9,792
Cash and Cash Equivalents	56,251	74,518
Investment securities available for sale, at fair value	345,982	382,098
Investment securities held-to-maturity, at amortized cost (approximate fair value at September 30, 2008 and December 31, 2007 - $22,997 and $35,198, respectively)	33,033	34,918
Total Investment Securities	379,015	417,016
Gross loans	1,777,731	1,767,021
Allowance for loan losses	(18,879)	(17,581)
Net Loans	1,758,852	1,749,440
Bank owned life insurance	69,660	64,467
Premises and equipment	59,574	54,635
Accrued interest receivable	9,733	11,254
Net deferred tax asset	41,173	20,633
Intangible assets	57,600	58,238
Other assets	33,707	32,566
Total Assets	$ 2,465,565	$ 2,482,767
Liabilities		
Deposits:		
Noninterest-bearing	$ 316,205	$ 314,231
Interest-bearing:		
Demand deposits	404,593	397,510
Savings deposits	359,644	350,607
Time deposits	912,184	927,733
Total Deposits	1,992,626	1,990,081
Short-term borrowings	140,726	161,916
Long-term debt	21,075	4,973
Other liabilities	26,226	31,803
Total Liabilities	2,180,653	2,188,773
Shareholders’ Equity		
Preferred stock, par value $25 per share: 500,000 shares authorized; none issued	-	-
Common stock, par value $2.50 per share: 50,000,000 shares authorized; 18,499,282 shares issued at September 30, 2008 and December 31, 2007, less 2,316,638 and 2,292,357 shares in treasury, respectively	46,249	46,249
Capital surplus	102,831	103,390

Retained earnings	231,789	224,386
Cost of common stock in treasury	(81,480)	(80,664)
Accumulated other comprehensive (loss) income:		
Unrealized loss on securities available-for-sale	(20,631)	(1,783)
Unrealized gain on derivative instruments	8,128	4,390
Underfunded pension liability	(1,974)	(1,974)
Total Accumulated Other Comprehensive (Loss) Income	(14,477)	633
Total Shareholders' Equity	284,912	293,994
Total Liabilities and Shareholders' Equity	$ 2,465,565	$ 2,482,767

See notes to consolidated financial statements.

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Consolidated Statements of Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands, except earnings per share data)

	Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007
Interest Income				
Interest and fees on loans	$ 30,254	$ 32,721	$ 91,662	$ 96,131
Interest on investment securities:				
Taxable	5,850	6,024	18,034	19,709
Tax-exempt	371	415	1,151	1,270
Interest on deposits in depository institutions	47	171	163	401
Interest on federal funds sold	-	266	-	815
Total Interest Income	36,522	39,597	111,010	118,326
Interest Expense				
Interest on deposits	9,446	13,190	31,980	38,978
Interest on short-term borrowings	478	1,758	2,286	4,965
Interest on long-term debt	317	426	1,070	1,383
Total Interest Expense	10,241	15,374	35,336	45,326
Net Interest Income	26,281	24,223	75,674	73,000
Provision for loan losses	2,350	1,200	5,083	3,700
Net Interest Income After Provision for Loan Losses	23,931	23,023	70,591	69,300
Non-interest Income				
Investment securities (losses) gains	(27,467)	(1)	(27,465)	45
Service charges	11,993	11,192	34,536	32,681
Insurance commissions	1,025	1,127	3,231	2,971
Trust and investment management fee income	640	523	1,721	1,529
Bank owned life insurance	767	596	2,193	1,877
Gain on sale of retail credit card merchant agreements	-	-	-	1,500
VISA IPO Gain	-	-	3,289	-
Other income	284	377	1,250	1,252
Total Non-interest Income	(12,758)	13,814	18,755	41,855
Non-interest Expense				
Salaries and employee benefits	9,538	9,307	28,418	27,275
Occupancy and equipment	1,800	1,600	5,098	4,762
Depreciation	1,110	1,160	3,330	3,339
Professional fees	435	416	1,229	1,204
Postage, delivery, and statement mailings	636	641	1,908	1,988
Advertising	821	801	2,081	2,533
Telecommunications	496	438	1,354	1,352
Bankcard expenses	717	623	1,978	1,737
Insurance and regulatory	354	364	1,025	1,132
Office supplies	527	472	1,488	1,369
Repossessed asset losses (gains), net of expenses	314	(47)	437	(52)

Loss on early extinguishment of debt	-	-	1,208	-
Other expenses	2,498	2,256	8,352	6,514
Total Non-interest Expense	19,246	18,031	57,906	53,153
(Loss) Income Before Income Taxes	(8,073)	18,806	31,440	58,002
Income tax (benefit) expense	(5,516)	6,092	7,580	19,735
Net (Loss) Income	(2,557)	12,714	23,860	38,267
Basic (loss) earnings per common share	$ (0.16)	$ 0.76	$ 1.48	$ 2.24
Diluted (loss) earnings per common share	$ (0.16)	$ 0.76	$ 1.47	$ 2.24
Dividends declared per common share	$ 0.34	$ 0.31	$ 1.02	$ 0.93
Average common shares outstanding:				
Basic	16,142	16,714	16,130	17,057
Diluted	16,195	16,767	16,189	17,116

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
City Holding Company and Subsidiaries
Nine Months Ended September 30, 2008 and 2007
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive (Loss)	Total Shareholders' Equity
Balances at December 31, 2006	$ 46,249	$ 104,043	$ 194,213	$ (33,669)	$ (5,529)	$ 305,307
Comprehensive income:						
Cumulative effect of adopting FIN 48			(125)			(125)
Net income			38,267			38,267
Other comprehensive gains, net of deferred income taxes of $755:						
Unrealized gains on available-for-sale securities of $138, net of taxes					83	83
Net unrealized gain on interest rate floors of $1,750, net of taxes					1,050	1,050
Total comprehensive income						39,400
Cash dividends declared ($0.93 per share)			(15,703)			(15,703)
Issuance of stock awards, net		(430)		802		372
Exercise of 7,300 stock options		(141)		295		154
Excess tax benefit on stock-based compensation		3				3
Purchase of 1,017,000 treasury shares				(37,688)		(37,688)
Balances at September 30, 2007	$ 46,249	$ 103,475	$ 216,652	$ (70,260)	$ (4,396)	$ 291,720

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances at December 31, 2007	$ 46,249	$ 103,390	$ 224,386	$ (80,664)	$ 633	$ 293,994
Comprehensive income:						
Net income			23,860			23,860

Other comprehensive loss, net of deferred income taxes of $10,073:						
Unrealized losses on available-for-sale securities of $31,413, net of taxes					(18,848)	(18,848)
Net unrealized gain on interest rate floors of $6,230, net of taxes					3,738	3,738
Total comprehensive income						8,750
Cash dividends declared ($1.02 per share)			(16,457)			(16,457)
Issuance of stock awards, net		(81)		491		410
Exercise of 66,254 stock options		(744)		2,410		1,666
Excess tax benefit on stock-based compensation		266				266
Purchase of 104,960 treasury shares				(3,717)		(3,717)
Balances at September 30, 2008	$ 46,249	$ 102,831	$ 231,789	$ (81,480)	$ (14,477)	$ 284,912

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Nine Months Ended September 30 2008	2007
Operating Activities		
Net income	$ 23,860	$ 38,267
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and accretion	(1,012)	(1,754)
Provision for loan losses	5,083	3,700
Depreciation of premises and equipment	3,330	3,339
Deferred income tax benefit	(10,467)	(472)
Net periodic employee benefit cost	36	177
Gain on sale of credit card merchant agreements	-	(1,500)
Loss on early extinguishment of debt	1,208	-
Loss on disposal of premises and equipment	125	-
Realized investment securities losses (gains)	27,465	(45)
Proceeds from bank-owned life insurance	-	205
Increase in value of bank-owned life insurance	(2,193)	(1,878)
Decrease in accrued interest receivable	1,521	82
Increase in other assets	(4,226)	(1,658)
Decrease in other liabilities	(5,561)	(2,980)
Net Cash Provided by Operating Activities	39,169	35,483
Investing Activities		
Proceeds from maturities and calls of securities held-to-maturity	1,467	11,458
Proceeds from sale of money market and mutual fund securities available-for-sale	781,757	753,770
Purchases of money market and mutual fund securities available-for-sale	(781,623)	(775,703)
Proceeds from sales of securities available-for-sale	2,823	1,811
Proceeds from maturities and calls of securities available-for-sale	45,619	70,218
Purchases of securities available-for-sale	(71,470)	(12,085)
Net increase in loans	(11,615)	(41,388)
Sales of premises and equipment	340	15
Purchases of premises and equipment	(8,734)	(10,226)
Proceeds from sale of credit card merchant agreements	-	1,650
Investment in bank-owned life insurance	(3,000)	-
Redemption of VISA stock	2,334	-
Proceeds from sale of derivative instrument	5,669	-
Net Cash Used in Investing Activities	(36,433)	(480)
Financing Activities		
Net increase (decrease) in noninterest-bearing deposits	1,974	(21,219)
Net increase in interest-bearing deposits	571	18,677
Net (decrease) increase in short-term borrowings	(4,631)	3,184
Proceeds from long-term debt	16,495	-
Repayment of long-term debt	(79)	(135)

Redemption of trust preferred securities	(17,569)	-
Purchases of treasury stock	(3,717)	(37,688)
Proceeds from exercise of stock options	1,666	154
Excess tax benefits from stock-based compensation arrangements	266	3
Dividends paid	(15,979)	(15,484)
Net Cash Used in Financing Activities	(21,003)	(52,508)
Decrease in Cash and Cash Equivalents	(18,267)	(17,505)
Cash and cash equivalents at beginning of period	74,518	110,448
Cash and Cash Equivalents at End of Period	$ 56,251	$ 92,943

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

Note A – Basis of Presentation

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of City Holding Company ("the Parent Company") and its wholly-owned subsidiaries (collectively, "the Company"). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2008. The Company's accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management's estimates.

The consolidated balance sheet as of December 31, 2007 has been derived from audited financial statements included in the Company's 2007 Annual Report to Shareholders. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2007 Annual Report of the Company.

Note B –Previously Securitized Loans

Between 1997 and 1999, the Company completed six securitization transactions involving approximately $760 million in 125% of fixed rate, junior-lien underlying mortgages. The Company retained a financial interest in each of the securitizations until 2004. Principal amounts owed to investors were evidenced by securities ("Notes"). During 2003 and 2004, the Company exercised its early redemption options on each of those securitizations. Once the Notes were redeemed, the Company became the beneficial owner of the mortgage loans and recorded the loans as assets of the Company within the loan portfolio. The table below summarizes information regarding delinquencies, net credit recoveries, and outstanding collateral balances of previously securitized loans for the dates presented:

(in thousands)	As of and for the Nine Months Ended September 30, 2008	2007	As of and for the Year Ended December 31, 2007
Previously Securitized Loans:			
Total principal amount of loans outstanding	$ 19,812	$ 25,947	$ 24,062
Discount	(15,292)	(17,630)	(17,170)
Net book value	$ 4,520	$ 8,317	$ 6,892
Principal amount of loans between 30 and 89 days past due	$ 558	$ 865	$ 1,099
Principal amount of loans 90 days and above past due	40	176	76
Net credit recoveries during the period	334	2,506	2,938

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The Company accounts for the difference between the carrying value and the total expected cash flows from these loans as an adjustment of the yield earned on the loans over their remaining lives. The discount is accreted to income over the period during which payments are probable of collection and are reasonably estimable. Additionally, the collectibility of previously securitized loans is evaluated over the remaining lives of the loans. An impairment charge on previously securitized loans would be provided through the Company's provision for loan losses if the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans. No such impairment charges were recorded for the three and nine months ended September 30, 2008 and 2007, or for the year ending December 31, 2007.

As of September 30, 2008, the Company reported a book value of previously securitized loans of $4.5 million whereas the actual contractual outstanding balance of previously securitized loans at September 30, 2008 was $19.8 million. The difference ("the discount") between the book value and the expected total cash flows from previously securitized loans is being accreted into interest income over the estimated remaining life of the loans.

For the three months ended September 30, 2008 and 2007, the Company recognized $1.3 million and $1.9 million, respectively, of interest income from its previously securitized loans. During the first nine months of 2008 and 2007, the Company recognized $4.3 million and $5.5 million, respectively, of interest income from its previously securitized loans.

Note C –Derivative Instruments

The Company utilizes interest rate floors to mitigate exposure to interest rate risk. As of September 30, 2008, the Company has entered into six interest rate floor contracts with a total notional amount of $400 million, which are designated as cash flow hedges. The objective of these interest rate floors is to protect the overall cash flows from the Company's portfolio of $400 million of variable-rate loans outstanding from the risk of a decrease in those cash flows.

The notional amounts and estimated fair values of interest rate floor derivative positions outstanding at period end are presented in the following table. The estimated fair values of the interest rate floors on variable-rate loans are based on quoted market prices.

	September 30, 2008		December 31, 2007	
(in thousands)	Notional Value	Estimated Fair Value	Notional Value	Estimated Fair Value
Interest rate floors on variable-rate loans	$ 400,000	$ 11,171	$ 500,000	$ 11,362

The weighted-average strike rates for interest rate floors outstanding at September 30, 2008 range from 6.00% to 7.75%.

Interest rate contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. These counterparties must have an investment grade credit rating and be approved by the Company's Asset and Liability Committee.

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For cash flow hedges, the effective portion of the gain or loss on the derivative hedging instrument is reported in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is recorded in current earnings as other income or other expense. The Company recognized the increase in market value of $3.7 million, net of taxes, in Other Comprehensive Income for the nine months ended September 30, 2008 on these derivative instruments.

During the third quarter of 2008, the Company sold an interest rate floor with a notional value of $100 million, and a strike rate of 8.00%, that matured June 2011 in order to mitigate its risk associated with the counterparty of this interest rate floor. The gain from this sale of $4.2 million will be recognized over the remaining life of the hedged loans.

Note D – Short-term borrowings

The components of short-term borrowings are summarized below:

(in thousands)	September 30, 2008	December 31, 2007
Security repurchase agreements	$ 128,958	$ 119,554
Short-term advances	11,768	25,526
Junior subordinated debentures owed to City Holding Capital Trust	-	16,836
Total short-term borrowings	$ 140,726	$ 161,916

The junior subordinated debentures owed to City Holding Capital Trust were fully redeemed during the first quarter of 2008 and as a result, the Company incurred a loss of $1.2 million. Securities sold under agreement to repurchase were sold to corporate and government customers as an alternative to available deposit products. The underlying securities included in repurchase agreements remain under the Company's control during the effective period of the agreements.

Note E – Long-Term Debt

The components of long-term debt are summarized below:

(dollars in thousands)	Maturity	September 30, 2008	Weighted Average Interest Rate
FHLB Advances	2009	$ 3,010	6.05%
FHLB Advances	2010	1,000	5.98%
FHLB Advances	2011	570	4.45%
Junior subordinated debentures owed to City Holding Capital Trust III	2038 (a)	16,495	6.31%
Total long-term debt		$ 21,075	

(a) Junior Subordinated Debentures owed to City Holding Capital Trust III are redeemable prior to maturity at the option of the Company (i) in whole at any time or in part from time-to-time, at declining redemption prices ranging from 103.525% to 100.00% on June 15, 2013, and thereafter, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of certain pre-defined events.

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The Company formed a statutory business trust, City Holding Capital Trust III ("Capital Trust III"), under the laws of Delaware. Capital Trust III was created for the exclusive purpose of (i) issuing trust-preferred capital securities ("Capital Securities"), which represent preferred undivided beneficial interests in the assets of the trust, (ii) using the proceeds from the sale of the Capital Securities to acquire junior subordinated debentures ("Debentures") issued by the Company, and (iii) engaging in only those activities necessary or incidental thereto. The trust is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, the accounts of the trusts are not included in the Company's consolidated financial statements.

The Capital Securities issued by the statutory business trust qualify as Tier 1 capital for the Company under the Federal Reserve Board guidelines. In March 2005, the Federal Reserve Board issued a final rule that allows the inclusion of trust preferred securities issued by unconsolidated subsidiary trusts in Tier 1 capital, but with stricter limits. Under ruling, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. The Company expects to continue to include all of its $16 million in trust preferred securities in Tier 1 capital. The trust preferred securities could be redeemed without penalty if they were no longer permitted to be included in Tier 1 capital.

Note F – Employee Benefit Plans

The Company accounts for share-based compensation in accordance with SFAS No. 123R, "Share-Based Payment." A summary of the Company's stock option activity and related information is presented below for the nine months ended September 30:

	2008		2007	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at January 1	305,909	$ 32.05	271,709	$ 30.51
Granted	11,500	40.88	47,500	39.34
Exercised	(66,254)	25.15	(7,300)	21.17
Forfeited	-	-	(3,000)	34.45
Outstanding at September 30	251,155	$ 34.23	308,909	$ 32.05

Additional information regarding stock options outstanding and exercisable at September 30, 2008, is provided in the following table:

Ranges of Exercise Prices	No. of Options Outstanding