CADENCE FINANCIAL CORP
Form 10-Q
November 15, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 1-15773

CADENCE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Mississippi	**64-0694775**
(State or other jurisdiction of	**(I. R. S. Employer**
incorporation or organization)	**Identification No.)**
301 University Drive, P. O. Box 1187, Starkville, Mississippi	**39760**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes ¨ No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

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

Common Stock, $1 Par Value 11,909,127 shares as of September 30, 2010.

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PART I FINANCIAL INFORMATION

CADENCE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

(Unaudited)

(Amounts in thousands, except per share data)	**2010**	**2009**
INTEREST INCOME		
Interest and fees on loans	$ 39,242	$ 47,639
Interest and dividends on securities	10,829	14,333
Other interest income	576	273
Total interest income	50,647	62,245
INTEREST EXPENSE		
Interest on deposits	16,570	21,690
Interest on borrowed funds	4,056	5,993
Total interest expense	20,626	27,683
Net interest income	30,021	34,562
Provision for loan losses	13,317	76,460
Net interest income (loss) after provision for loan losses	16,704	(41,898)
OTHER INCOME		
Service charges on deposit accounts	5,427	6,349
Trust Department income	1,519	1,500
Other income	3,932	4,896
Securities gains (losses), net	838	1,062
Total other income	11,716	13,807
OTHER EXPENSE		
Salaries and employee benefits	17,952	20,984
Premises and fixed asset expense	5,674	5,682
Impairment loss on goodwill		66,542
Other expense	21,029	19,637
Total other expense	44,655	112,845
Income (loss) from continuing operations, before income taxes	(16,235)	(140,936)
Income tax expense (benefit)	(5,957)	(30,053)

Net income (loss) from continuing operations	(10,278)	(110,883)
Income (loss) from discontinued operations, before income taxes		649
Income tax expense (benefit)		364
Net income (loss) from discontinued operations		285
Net income (loss)	(10,278)	(110,598)
Preferred stock dividend and accretion of discount	1,425	1,626
Net income (loss) applicable to common shareholders	$ (11,703)	$ (112,224)
Net income (loss) per share from continuing operations - basic and diluted	$ (0.86)	$ (9.31)
Net income (loss) per share from discontinued operations - basic and diluted	$	$ 0.02
Net income (loss) per share - basic and diluted	$ (0.86)	$ (9.28)
Net income (loss) applicable to common shareholders per share - basic and diluted	$ (0.98)	$ (9.42)
Dividends per common share	$	$ 0.05

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CADENCE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

(Unaudited)

(Amounts in thousands, except per share data)	**2010**	**2009**
INTEREST INCOME		
Interest and fees on loans	$ 12,412	$ 15,464
Interest and dividends on securities	3,433	4,608
Other interest income	233	98
Total interest income	16,078	20,170
INTEREST EXPENSE		
Interest on deposits	4,941	6,817
Interest on borrowed funds	1,359	1,760
Total interest expense	6,300	8,577
Net interest income	9,778	11,593
Provision for loan losses	8,495	20,704
Net interest income (loss) after provision for loan losses	1,283	(9,111)
OTHER INCOME		
Service charges on deposit accounts	1,688	2,219
Trust Department income	531	527
Other income	1,232	1,511
Securities gains (losses), net	5	923
Total other income	3,456	5,180
OTHER EXPENSE		
Salaries and employee benefits	5,825	6,902
Premises and fixed asset expense	1,868	1,910
Other expense	8,418	8,558
Total other expense	16,111	17,370
Income (loss) from continuing operations, before income taxes	(11,372)	(21,301)
Income tax expense (benefit)	(3,937)	(8,475)
Net income (loss) from continuing operations	(7,435)	(12,826)
Income (loss) from discontinued operations, before income taxes		646

Income tax expense (benefit)		247
Net income (loss) from discontinued operations		399
Net income (loss)	(7,435)	(12,427)
Preferred stock dividend and accretion of discount	109	652
Net income (loss) applicable to common shareholders	$ (7,544)	$ (13,079)
Net income (loss) per share from continuing operations - basic and diluted	$ (0.62)	$ (1.08)
Net income (loss) per share from discontinued operations - basic and diluted	$	$ 0.03
Net income (loss) per share - basic and diluted	$ (0.62)	$ (1.04)
Net income (loss) applicable to common shareholders per share - basic and diluted	$ (0.63)	$ (1.10)
Dividends per common share	$	$

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CADENCE FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)	Sept. 30, 2010 (Unaudited)	Dec. 31, 2009
ASSETS		
Cash and due from banks	$ 28,762	$ 17,450
Interest-bearing deposits with banks	267,373	249,460
Federal funds sold and securities purchased under agreements to resell	1,744	30,125
Total cash and cash equivalents	297,879	297,035
Securities available-for-sale	361,978	330,079
Securities held-to-maturity (estimated fair value of $2,717 at September 30, 2010 and $2,741 at December 31, 2009)	2,667	2,671
Other securities	13,240	13,313
Total securities	377,885	346,063
Loans	944,967	1,091,477
Less: allowance for loan losses	(38,179)	(43,422)
Net loans	906,788	1,048,055
Interest receivable	5,961	7,338
Premises and equipment, net	30,008	31,247
Goodwill and other intangible assets	1,033	1,384
Other assets	113,569	113,333
Total Assets	$ 1,733,123	$ 1,844,455
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Noninterest-bearing deposits	$ 181,110	$ 170,722
Interest-bearing deposits	1,218,934	1,329,088
Total deposits	1,400,044	1,499,810
Interest payable	1,458	2,046
Federal funds purchased and securities sold under agreements to repurchase	82,055	87,432
Subordinated debentures	30,928	30,928
Other borrowed funds	96,484	96,640
Other liabilities	10,162	7,845
Total liabilities	1,621,131	1,724,701
Shareholders Equity:		
Preferred stock $10 par value, authorized 10,000,000 shares as of September 30, 2010 and December 31, 2009; issued 44,000 shares as of September 30, 2010 and December 31, 2009	42,422	42,097
Common stock $1 par value, authorized 140,000,000 shares as of September 30, 2010 and 50,000,000 shares as of December 31, 2009; issued 11,909,127 shares as of September 30, 2010 and 11,912,564 shares as of December 31, 2009	11,909	11,913

Surplus	96,035	95,931
Retained earnings (accumulated deficit)	(44,535)	(32,832)
Accumulated other comprehensive income	6,161	2,645
Total shareholders equity	111,992	119,754
Total Liabilities and Shareholders Equity	$ 1,733,123	$ 1,844,455

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CADENCE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

(Unaudited)

(Amounts in thousands)	**2010**	**2009**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (10,278)	$ (110,598)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,344	2,628
Deferred income taxes	(7,228)	(25,312)
Provision for loan losses	13,317	76,460
Net performance share activity	100	81
Loss (gain) on sale of securities, net	(838)	(1,062)
Impairment loss on goodwill		66,542
Gain on sale of GCM Insurance assets		(502)
(Increase) decrease in interest receivable	1,377	1,603
(Increase) decrease in loans held for sale	1,021	1,839
(Increase) decrease in other assets	4,604	(326)
Increase (decrease) in interest payable	(588)	(1,023)
Increase (decrease) in other liabilities	2,161	1,462
Net cash provided by (used in) operating activities	5,992	11,792
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and calls of securities	92,421	426,413
Proceeds from sale of securities	28,181	114,562
Purchase of securities	(145,892)	(518,992)
Net cash proceeds from sale of GCM Insurance assets		417
(Increase) decrease in loans	126,929	94,498
(Additions) disposal of premises and equipment	(544)	(43)
Net cash provided by (used in) investing activities	101,095	116,855
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in deposits	(99,766)	(49,715)
Issuance of preferred stock		44,000
Dividend paid on preferred stock	(1,100)	(1,320)
Dividend paid on common stock		(595)
Net change in federal funds purchased and securities sold under agreements to repurchase	(5,377)	(9,736)
Net change in short-term FHLB borrowings		(20,000)
Proceeds from long-term debt		35,000
Repayment of long-term debt		(102,277)
Net cash provided by (used in) financing activities	(106,243)	(104,643)
Net increase (decrease) in cash and cash equivalents	844	24,004
Cash and cash equivalents at beginning of year	297,035	61,233
Cash and cash equivalents at end of period	$ 297,879	$ 85,237

Cash paid during the period for:				
Interest	$	21,214	$	28,706
Income tax	$		$	

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CADENCE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements include the accounts of Cadence Financial Corporation (the Corporation), Cadence Bank, N.A. (Cadence or the Bank), a wholly-owned subsidiary of the Corporation, Enterprise Bancshares, Inc. (Enterprise), a wholly-owned subsidiary of the Corporation, Cadence Insurance Services of Mississippi (formerly Galloway-Chandler-McKinney Insurance Agency, Inc. (GCM)), a wholly-owned subsidiary of Cadence, NBC Insurance Services of Alabama, Inc., a wholly-owned subsidiary of Cadence, and NBC Service Corporation (NBC Service), a wholly-owned subsidiary of Cadence. All significant intercompany accounts and transactions have been eliminated.

On August 31, 2010, Commerce National Insurance Company, a wholly-owned subsidiary of NBC Service, was liquidated, and its assets and liabilities were transferred to NBC Service. This transaction did not impact the Corporation s financial position or results of operations. On August 31, 2009, the Bank completed the disposition of the assets used in and liabilities arising from GCM s operations and changed its name to Cadence Insurance Services of Mississippi. See Note 11 for additional information relating to this transaction.

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

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

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Corporation s annual report on Form 10-K for the year ended December 31, 2009.

The Corporation s management has evaluated the effect of subsequent events on these financial statements through the date the financial statements were issued.

Note 1. Merger Proceedings

On October 6, 2010, Community Bancorp LLC, a Delaware limited liability company (CBC) and the Corporation entered into an Agreement and Plan of Merger (Agreement) pursuant to which a wholly-owned subsidiary of CBC will be merged with and into the Corporation, with the Corporation continuing thereafter as a wholly-owned subsidiary of CBC (the Merger).

Under the terms of the Agreement, the Corporation s common shareholders will receive a cash payment of $2.50 per share, which approximates $29.8 million. In addition, the Corporation has been notified that CBC has entered into an agreement with the U.S. Department of the Treasury (Treasury) to purchase the $44.0 million of the Corporation s preferred stock and the associated warrant issued to Treasury under the Capital Purchase Program for $38.0 million in cash, plus approximately $1.0 million in cash for accrued but unpaid dividends with respect to the preferred stock through October 29, 2010, subject to certain closing conditions. Consummation of the Merger is subject to approval by regulatory authorities, approval by the Corporation s shareholders, and certain other conditions set forth in the Agreement. The Merger is expected to close no later than the first quarter of 2011. Following the consummation of the Merger, the Corporation will no longer be a publicly held corporation.

Note 2. Recently Issued Accounting Pronouncements

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This guidance will require companies to provide additional disclosures relating to the credit quality of their financing receivables and the credit reserves held against them, including the aging of past-due receivables, credit quality indicators, and modifications of financing receivables. For public companies, the disclosure requirements as of the

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end of a reporting period are effective for periods ending on or after December 15, 2010, and the disclosure requirements for activity occurring during a reporting period are effective for periods beginning on or after December 15, 2010. For nonpublic companies, the disclosure requirements are effective for annual reporting periods ending on or after December 15, 2011. The Corporation is currently evaluating the possible effects of this guidance on its financial statement disclosures.

Note 3. Goodwill and Other Intangible Assets

Goodwill represents the cost of acquired institutions in excess of the fair value of the net assets acquired. In accordance with FASB Accounting Standards Codification (ASC) Topic 350, Intangibles-Goodwill and Other, the Corporation did not amortize goodwill but periodically tested it for impairment using a two-step approach. The first step is to determine whether impairment could exist. If the results of the first step of testing indicate that impairment does not exist, the test is complete. If the results of the first step indicate that impairment could exist, the second step of testing must be performed. The Corporation completed its periodic impairment test in accordance with ASC 350 as of September 30, 2008. Based on the results of the first step of testing, management concluded that no impairment writedown was warranted as of September 30, 2008.

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

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

Note 4. Performance Shares and Stock Options

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

The Corporation has one active Long Term Incentive Compensation Plan (the LTIP), which is administered by the Compensation Committee of the Board of Directors. Under the LTIP, 750,000 shares of common stock have been reserved for issuance to the Corporation s eligible employees, as well as the directors and employees of certain of the Corporation s affiliates. In 2007 and 2008, under the provisions of the LTIP, the Compensation Committee awarded performance shares of stock to certain eligible employees. No awards were granted in 2009 or in the nine month period ended September 30, 2010. The shares vest in equal amounts over a four-year period after they are earned.

As of September 30, 2010, a total of 38,945 performance shares are outstanding, all of which have been earned. For the three and nine months ended September 30, 2010, compensation expense relating to performance shares totaled $35,000 and $101,000, respectively. For the three and nine months ended September 30, 2009, compensation expense relating to performance shares totaled $51,000 and $119,000, respectively.

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Note 5. Variable Interest Entities

On December 30, 2003, the Corporation issued $30.9 million of subordinated debentures to NBC Capital Corporation (MS) Statutory Trust (Trust). The Trust in turn sold approximately $30 million of trust preferred securities to investors. The Corporation s obligations under the Debentures and related documents, taken together, practically constitute a full and unconditional guarantee by the Corporation of the trust preferred securities.

On August 9, 2010, the Board of Directors voted to defer regular interest payments on the subordinated debentures issued to the Trust. The Debentures provide for the deferral, from time to time, of the payment of interest of up to 20 consecutive quarterly periods. During these deferral periods, no interest shall be due and payable. At the end of the deferral period, the Corporation shall pay all accrued and unpaid interest on the Debentures, along with additional interest calculated by compounded interest payments quarterly. Interest on the Debentures, as well as the trust preferred securities, is the three month London Interbank Offer Rate (LIBOR) plus 2.85% and is payable quarterly. The Board of Directors believes the deferral of the payment of interest on the Debentures is in the best interest of the Corporation at the present time given the Corporation s desire to conserve and maintain liquidity.

The subordinated debentures are the sole assets of the Trust. In accordance with ASC Topic 810, Consolidation, the Trust is not consolidated into the financial statements of the Corporation.

Note 6. Comprehensive Income

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

	Nine Months Ended September 30,	
(Amounts in thousands)	**2010**	**2009**
Net income (loss)	$ (10,278)	$ (110,598)
Net change in other comprehensive income, net of tax:		
Realized (gains) losses included in net income	(517)	(656)
Unrealized gains (losses) on securities	4,033	4,282
Net change in other comprehensive income, net of tax	3,516	3,626
Comprehensive income (loss)	$ (6,762)	$ (106,972)
Accumulated other comprehensive income at beginning of period	$ 2,645	$ 237
Net change in other comprehensive income	3,516	3,626
Accumulated other comprehensive income at end of period	$ 6,161	$ 3,863

	Three Months Ended September 30,	
(Amounts in thousands)	**2010**	**2009**
Net income (loss)	$ (7,435)	$ (12,427)
Net change in other comprehensive income, net of tax:		
Realized (gains) losses included in net income	(3)	(570)
Unrealized gains (losses) on securities	116	4,812
Net change in other comprehensive income, net of tax	113	4,242
Comprehensive income (loss)	$ (7,322)	$ (8,185)

Accumulated other comprehensive income at beginning of period	$ 6,048	$ (379)
Net change in other comprehensive income	113	4,242
Accumulated other comprehensive income at end of period	$ 6,161	$ 3,863

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Note 7. Defined Benefit Pension Plan

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

	Nine Months Ended September 30,	
(Amounts in thousands)	**2010**	**2009**
Service cost	$ 516	$ 535
Interest cost	497	559
Expected return on assets	(601)	(676)
Net (gain)/loss recognition	268	252
Prior service cost amortization	(59)	(66)
Preliminary net periodic cost	621	604
Immediate recognition due to settlement and curtailment	450	666
Net periodic cost	$ 1,071	$ 1,270

	Three Months Ended September 30,	
(Amounts in thousands)	**2010**	**2009**
Service cost	$ 172	$ 178
Interest cost	166	186
Expected return on assets	(200)	(225)
Net (gain)/loss recognition	89	84
Prior service cost amortization	(20)	(22)
Preliminary net periodic cost	207	201
Immediate recognition due to settlement and curtailment	150	222
Net periodic cost	$ 357	$ 423

The expected rate of return for 2010 and 2009 was 7.0%.

Note 8. Investment Securities

In accordance with ASC Topic 320, Investments Debt and Equity Securities, for the three and nine month periods ended September 30, 2010, management reviewed the securities portfolio for securities that had unrealized losses for more than twelve months that could be considered other-than-temporary. As of September 30, 2010, approximately 2% of the number of securities in the portfolio reflected an unrealized loss.

In conducting its review for other-than-temporary impairment, management evaluated a number of factors including, but not limited to the following: the amount of the unrealized loss; the length of time in which the unrealized loss has existed; the financial condition of the issuer; rating agency changes on the issuer; and management s intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. Based on this review, management does not believe any individual security with an unrealized loss as of September 30, 2010, is other-than-temporarily impaired.

Note 9. Fair Value

The following disclosure of the estimated fair value of financial instruments is made in accordance with ASC Topic 825, Financial Instruments. The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

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

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

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

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

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

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

Subordinated Debentures The floating rate junior subordinated deferrable interest debentures (Debentures) bear interest at a variable rate and the carrying value approximates the fair value.

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

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

	September 30, 2010		**December 31, 2009**	
(Amounts in thousands)	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial Instruments:				
Assets:				
Cash and cash equivalents	$ 297,879	$ 297,879	$ 297,035	$ 297,035
Securities available-for-sale	361,978	361,978	330,079	330,079
Securities held-to-maturity	2,667	2,717	2,671	2,741
Other securities	13,240	13,240	13,313	13,313
Loans	906,788	907,032	1,048,055	1,049,952
Liabilities:				
Noninterest-bearing deposits	181,110	181,110	170,722	170,722
Interest-bearing deposits	1,218,934	1,221,308	1,329,088	1,332,685
Federal funds purchased and securities sold under agreements to repurchase	82,055	82,715	87,432	89,582
Subordinated debentures	30,928	30,928	30,928	30,928
FHLB and other borrowings	96,484	95,124	96,640	94,985

ASC Topic 820, Fair Value Measurements and Disclosures, provides guidance for using fair value to measure assets and liabilities and establishes a hierarchy to prioritize the inputs used to measure fair value. The fair value hierarchy gives the highest priority to a valuation based on quoted prices in active markets for identical assets and liabilities (Level 1), moderate priority to a valuation based on quoted prices in active markets for similar assets and liabilities and/or based on assumptions that are observable in the market (Level 2), and the lowest priority to a valuation based on assumptions that are not observable in the market (Level 3).

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In accordance with the disclosure requirements of ASC Topic 820, the following table reflects assets measured at fair value on a recurring basis as of September 30, 2010. U. S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available-for-sale are reported at fair value using Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U. S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions, among other things.

(Amounts in thousands)	Total	Level 1	Level 2
Available-for-sale securities:			
U. S. Treasury securities	$ 40,468	$ 40,468	$
Obligations of other U. S. government agencies	22,425		22,425
Obligations of states and municipal subdivisions	31,560		31,560
Mortgage-backed securities	228,162		228,162
Other securities	39,363		39,363
Total	$ 361,978	$ 40,468	$ 321,510

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

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

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

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

(Amounts in thousands)	Fair Value at September 30, 2010
Impaired loans	$ 74,505
Other real estate owned	32,200

Note 10. Preferred Stock

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

On August 9, 2010, the Board of Directors voted to suspend quarterly dividends on the Senior Preferred Stock. The annual sum of quarterly dividend payments on the Senior Preferred Stock is $2.2 million for each of the first five years. The Senior Preferred Stock is non-voting, other than class voting on matters that could adversely affect the shares of Senior Preferred Stock, such as any authorizations of shares of capital stock ranking senior to the Senior Preferred Stock, any amendment to the terms of the Senior Preferred Stock, and any merger, exchange or similar transaction. If dividends on the Senior Preferred Stock are not paid in full for six dividend periods, whether or not consecutive, Treasury has the right to appoint two directors. This right will end when full dividends have been paid for four consecutive dividend periods. The Board of Directors believes the suspension of the dividend on the Senior Preferred Stock is in the best interest of the Corporation at the present time given the Corporation s desire to conserve and maintain liquidity. If dividends on the Senior Preferred Stock had not been suspended, the Corporation s net loss applicable to common shareholders for the three and nine months ended September 30, 2010, would have been $8.1 million ($0.68 per diluted share), and $12.3 million ($1.03 per diluted share), respectively.

Note 11. Discontinued Operations

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

As a result of this transaction, the Consolidated Statements of Income (Loss) for the three and nine months ended September 30, 2009, have been restated to reflect GCM s operations as discontinued operations. Summarized financial information for discontinued operations is as follows:

(Amounts in thousands)	**Nine Months Ended September 30, 2009**	**Three Months Ended September 30, 2009**
Income	$ 3,449	$ 1,044
Expense	3,302	900
Income from discontinued operations	147	144
Gain on sale	502	502
Income tax expense	364	247
Net income (loss) from discontinued operations	$ 285	$ 399

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

Forward-Looking Information

The following provides a narrative discussion and analysis of significant changes in our results of operations and financial condition for the three and nine months ended September 30, 2010. Certain information included in this discussion contains forward-looking statements and information that are based on management s beliefs, expectations and conclusions, drawn from certain assumptions and information currently available. The Private Securities Litigation Act of 1995 encourages the disclosure of forward-looking information by management by providing a safe harbor for such information. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although we believe that the expectations and conclusions reflected in such forward-looking statements are reasonable, such forward-looking statements are based on numerous assumptions (some of which may prove to be incorrect) and are subject to risks and uncertainties, which could cause the actual results to differ materially from our expectations. When used in this discussion, the words anticipate, believe, estimate, expect, objective, project, forecast, goal expressions are intended to identify forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, factors that could cause our actual results to differ materially from those contemplated in any forward-looking statements include, among others, increased competition, regulatory factors, economic conditions, changing interest rates, changing market conditions (including specifically the downturn in the U. S. real estate market), availability or cost of capital, changes in accounting standards and practices, employee workforce factors, ability to achieve cost savings and enhance revenues, the assimilation of acquired operations and establishing credit practices and efficiencies therein, acts of war or acts of terrorism or geopolitical instability and other effects of legal and administrative proceedings, changes in federal, state or local laws and regulations and other factors identified in

Item 1A, Risk Factors, and Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of our Annual Report on Form 10-K for the year ended December 31, 2009, and in Part II, Item 1A, Risk Factors, of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, and that may be discussed from time to time in other reports filed with the Securities and Exchange Commission subsequent to this report. Readers are cautioned not to place undue reliance on any forward-looking statements made by or on behalf of the Corporation. Any such statement speaks only as of the date the statement was made. We undertake no obligation to update or revise any forward-looking statements, whether as a result of changes in actual results, changes in assumptions or other factors affecting such statements.

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

Introduction and Management Overview

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

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

Summary of Nine Months Ended September 30, 2010

Consent Order Imposed by Office of the Comptroller of the Currency (OCC). On May 19, 2010, Cadence s Board of Directors executed a stipulation and consent to the issuance of a consent order by the OCC, and the OCC has issued a consent order effective as of that date. The consent order required the Bank to achieve by September 19, 2010, and maintain a minimum Tier 1 leverage ratio of 9.0% and a minimum total risk-based capital ratio of 12.0%. These capital ratios are higher than the typical capital ratios required to meet well-capitalized standards. The Bank is not deemed to be well-capitalized under the applicable regulations while the consent order is in place, even if the Bank satisfies the capital ratios discussed above. The consent order also includes operational and supervisory provisions which we believe we have satisfied or will be able to satisfy, including taking certain actions and implementing certain action plans with respect to, among other things, a compliance committee, capital adequacy, strategic planning and capital planning, management competence and effectiveness, loan portfolio management, credit and collateral exceptions, loan review, the allowance for loan and lease losses, criticized assets, credit concentration risk management, liquidity risk management, internal audit, and correcting alleged legal violations identified in examination reports. Most of these action plans require that the Bank satisfy the requirements within a defined time period ranging from 30 to 120 days. The consent order terminates the earlier formal agreement entered into with the OCC on April 17, 2009.

Net Interest Income. Our net interest income declined from $34.6 million in the first nine months of 2009 to $30.0 million in the first nine months of 2010. For the first nine months of 2010, our net interest margin was 2.33%, compared to 2.47% for the first nine months of 2009. This thirteen basis point decline in margin resulted primarily from our intentionally building liquidity by accumulating deposits and investing in short-term assets with lower yields, the increase in the average balance of our nonaccrual loans, and the decline in our average earning assets. Our average earning assets declined by $152.1 million, or 8.1%, between the first nine months of 2009 and the first nine months of 2010. When comparing the first nine months of 2010 to the same period of 2009, we lost 51 basis points of yield on our earning assets but were able to reduce the cost of funds by 46 basis points.

Provision for Loan Losses. Our provision for loan losses was $13.3 million for the first nine months of 2010, as compared to $76.5 million for the first nine months of 2009. We incurred $18.6 million in net charge-offs for the first nine months of 2010, compared to $52.3 million for the first nine months of 2009. In 2009, we experienced a significant increase in non-performing loans, mostly due to real estate construction and development loans.

Other Income (Noninterest Income). Our noninterest income, exclusive of securities gains and losses, declined by $1.9 million, or 14.6%, between the first nine months of 2009 and the first nine months of 2010, due to lower service charges and other noninterest income, primarily our service charges on deposit accounts, generated by insufficient funds (NSF) fees, and mortgage loan fee income, as we significantly scaled back our activity in mortgage lending.

Other Expense (Noninterest Expense). During the first nine months of 2010, total noninterest expenses declined by $68.2 million from the same period of 2009. This decline mainly resulted from a $66.5 million impairment loss on goodwill recognized in the first quarter of 2009. Also contributing to the decline in noninterest expenses was a $3.0 million decline in salaries and employee benefits, resulting from certain staff reductions made as part of an earnings improvement project we commissioned during the first quarter of 2010. Our other noninterest expenses increased by $1.4 million between the first nine months of 2009 and the first nine months of 2010, primarily due to higher OREO-related expenses and one-time costs related to the earnings improvement project.

Net Income/(Loss). For the first nine months of 2010, we reported a net loss applicable to common shareholders of $11.7 million, or $(0.98) per common share, compared to a net loss of $112.2 million, or $(9.42) per common share, for the first nine months of 2009.

Loan Portfolio. As of September 30, 2010, our loan portfolio was $945.0 million, distributed among commercial real estate loans, commercial and industrial loans, 1-4 family mortgages and consumer loans. As of September 30, 2010, our loan portfolio was composed of approximately 55.0% variable rate loans and 45.0% fixed rate loans. Beginning in the third quarter of 2008, we made a concerted effort to reduce our concentration in commercial real estate loans, particularly residential construction and development loans, which typically have higher yields but also higher risk. Overall, our average loan balances declined by approximately $245.2 million, or 19.3%, from the first nine months of 2009 to the first nine months of 2010, from $1.269 billion for the first nine months of 2009 to $1.024 billion for the first nine months of 2010.

Investment Portfolio. The average balance of our investment portfolio was $364.5 million for the first nine months of 2010, compared to $448.4 million for the first nine months of 2009, representing a decrease of $84.0 million, or 18.7%. Our yield on securities declined by 30 basis points to 3.97% over this same period.

Federal Funds Sold and Other Interest-Bearing Assets. Our average balances in federal funds sold and other interest-bearing assets increased significantly from the first nine months of 2009 to the first nine months of 2010, from $157.2 million to $334.3 million. This increase resulted from our intentionally building liquidity by accumulating deposits and investing in short-term assets. Our yields on these assets remained flat at 0.23% for the first nine months of 2009 and the first nine months of 2010.

Deposits and Other Interest-Bearing Liabilities. Our overall cost of funds declined by 46 basis points from the first nine months of 2009 to the first nine months of 2010. Average borrowed funds declined by $81.7 million, or 27.9%, for the first nine months of 2010 compared to the first nine months of 2009. Average interest-bearing deposits declined to $1.340 billion for the first nine months of 2010, compared to $1.356 billion for the first nine months of 2009, a decrease of $16.3 million.

Recent Events

On October 6, 2010, the Corporation announced that it had entered into an agreement and plan of merger with Community Bancorp LLC (CBC), a Delaware limited liability company formed to invest in community banks. The terms of this agreement provide that a wholly-owned subsidiary of CBC will be merged with and into the Corporation, with the Corporation as the surviving entity and as a wholly-owned subsidiary of CBC.

Under the terms of the agreement, our common shareholders will receive a cash payment of $2.50 per share, which approximates $29.8 million. In addition, it is our understanding that CBC has entered into an agreement with the U.S. Department of the Treasury (Treasury) to purchase the $44.0 million of our preferred stock and the associated warrant issued to Treasury under the Capital Purchase Program for $38.0 million in cash, plus approximately $1.0 million in cash for accrued but unpaid dividends with respect to the preferred stock through October 29, 2010, subject to certain closing conditions. Consummation of the merger is subject to approval by regulatory authorities, approval by our shareholders at a shareholder meeting scheduled for December 2010, and certain other conditions set forth in the agreement. The merger is expected to close no later than the first quarter of 2011.

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Outlook for the Remainder of 2010

Our most significant challenges for the remainder of 2010 are credit quality, the continuing low interest rate environment, and returning to profitability. We have taken an aggressive stance in addressing credit issues in our loan portfolio to minimize future risks. We have increased our focus on underwriting standards and have revamped our loan policy. We also have a special assets team in place to manage workout situations and to assist in the timely disposition of defaulted assets. Our management information systems relating to loan concentrations provide us with current and detailed information about the status of the loans in our portfolio. We feel that these steps place us in a favorable position to manage credit quality; however, credit quality will remain an issue as long as current economic trends, including high unemployment rates and depressed real estate prices, continue.

We expect our loan portfolio balance to level off during the fourth quarter of 2010. However, we must still face the challenges of the current economic environment and flat loan demand, which will make it difficult for us to maintain our current loan portfolio balance as our existing credits pay down. Currently, we expect that interest rates will remain flat for the remainder of 2010. We based our 2010 projections, budgets and goals on these expectations. If these trends move differently than expected in either direction or speed, they could have a material impact on our financial condition and results of operations. The areas of our operations most directly impacted would be the net interest margin, loan and deposit growth and the provision for loan losses.

We also expect our wholesale borrowing costs and higher cost retail time deposits to continue to decline for the remainder of 2010. We intend to use our excess liquidity to absorb this decrease in liabilities. This should decrease our interest expense and improve our net interest income and net interest margin during the fourth quarter of 2010.

As part of the consent order agreed to with the OCC in May 2010, Cadence was required to achieve by September 19, 2010, and maintain on an ongoing basis, a Tier 1 leverage ratio of 9.0% and a total risk-based capital ratio of 12.0%. As of September 30, 2010, Cadence had a Tier 1 leverage ratio of 4.9% and a total risk-based capital ratio of 10.1%. Because of our recent losses and Cadence s requirement for additional capital to meet these higher ratios, we have actively sought additional capital. CBC has indicated that once the merger with CBC is completed, it will fund Cadence s operations so that Cadence s capital levels will exceed the requirements of the consent order. We expect the merger to close no later than the first quarter of 2011.

We will also continue our efforts to control noninterest expenses by working to achieve maximum efficiencies within our franchise. The earnings improvement project we commissioned during the first quarter of 2010 is continuing to provide us with opportunities to reduce our overhead expenses during the remainder of 2010 and forward. Our 2010 nine-month results of operations reflected savings due to restructuring certain operations and delivery channels to our customers and eliminating some redundant staff positions. We have established process improvement teams to focus on ongoing programs to enhance our efficiencies and improve the delivery of services to our customers. We expect that these programs will improve our product offerings, customer service, and overall profitability. These programs should be fully implemented by the end of 2010. We continue to leverage the investments in infrastructure that we have made over the past few years and believe that they will continue to have a positive impact on our costs going forward. Reducing our efficiency ratio remains a key objective. However, our noninterest expenses for 2010 will continue to be negatively affected by costs associated with OREO and increased FDIC insurance premiums.

We remain focused on our strategy to build future earnings and understand that improved asset quality and margin growth are the keys to achieving that strategy. We are managing our credit problems aggressively and refining our risk management processes in order to enhance our future earnings. Given recent regulatory actions, including our entry into the consent order, we have accumulated liquidity and have invested that liquidity primarily in short term assets with low returns. If this liquidity were invested in longer term assets with higher returns, we would expect to be profitable by the end of 2011.

Critical Accounting Policies and Other Accounting Issues

Our accounting and financial reporting policies conform to United States generally accepted accounting principles and to general practices within the banking industry. Note A of the Notes to Consolidated Financial Statements in our annual report contains a summary of our accounting policies. Management is of the opinion that Note A, read in conjunction with all other information in our annual report on Form 10-K for the year ended December 31, 2009, and the information in this quarterly report, including this Management s Discussion and Analysis, should be sufficient to provide the reader with the information needed to understand our financial condition and results of operations.

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

- the provision for loan losses and the resulting allowance for loan losses;
- the liability and expense relating to our pension and other postretirement benefit plans;
- issues relating to other-than-temporary impairment losses in the investment portfolio; and
- income taxes.

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

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

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

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

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Because there are additional risks of losses that cannot be quantified precisely or attributed to particular loans or types of loans, including general economic and business conditions and credit quality trends, we have established an unallocated portion of the allowance for loan losses based on our evaluation of these risks. The unallocated portion of our allowance is determined based on various factors, including general economic conditions of our market area, the growth, composition and diversification of our loan portfolio, types of collateral securing our loans, the experience level of our lending officers and staff, the quality of our credit risk management and the results of independent third party reviews of our classification of credits. The unallocated portion of the allowance for loan losses was $2.0 million, or 5.3% of the total allowance, as of September 30, 2010, and $2.7 million, or 6.3% of the total allowance, as of December 31, 2009.

Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for loan losses to Cadence s executive committee and our full Board of Directors, indicating any change in the allowance for loan losses since the last review and any recommendations as to adjustments in the allowance for loan losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as events change. The allowance for loan losses was $38.2 million as of September 30, 2010, compared to $43.4 million as of December 31, 2009, and represented 4.0% of outstanding loans as of both dates.

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

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

In selecting the expected rate of return, management, in consultation with the plan trustees, selected a rate based on assumptions compared to recent returns and economic forecasts. We consider the current allocation of the portfolio and the probable rates of return of each investment type. In selecting the appropriate discount rate, management, with the assistance of actuarial consultants, performs an analysis of the plan s projected benefit cash flows against discount rates from a national Pension Discount Curve (a yield curve used to measure pension liabilities). Based on the analysis, in 2009, management used a discount rate of 6.25% and an expected rate of return of 7.0%. From a historical perspective, the plan s rate of return for 2009 was 23.8%. Additionally, our philosophy has been to fund the plan annually to the maximum amount deductible under the Internal Revenue Service (IRS) rules. As of December 31, 2009, the plan had a current accumulated benefit obligation of approximately $10.5 million, and plan assets with a fair value of approximately $12.1 million.

ASC Topic 715, Compensation-Retirement Benefits, requires us to recognize the funded status of the plan (defined as the difference between the fair value of plan assets and the projected benefit obligation) on the balance sheet and to recognize in other comprehensive income any gains or losses and prior service costs or benefits not included as components of periodic benefit cost. Detailed information on our pension plan and the related impacts of these changes on the amounts recorded in our financial statements can be found in Note M (Employee Benefits) of the Notes to Consolidated Financial Statements in our December 31, 2009 Form 10-K.

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

- the length of time and extent to which the current market value is less than cost;
- evidence of a forecasted recovery;

financial condition and the industry environment of the issuer, including whether the issuer is a government or government-backed agency (all of the mortgage-backed securities and collateralized mortgage obligations in our portfolio are issued by government-backed agencies);

downgrades of the securities by rating agencies;

whether there has been a reduction or elimination of dividends or interest payments;

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

interest rate trends that may impact recovery and realization.

As of September 30, 2010, our investment portfolio included certain securities that were impaired by definition, but based on our review and consideration of the criteria listed above, we determined that none of the impairments were other-than-temporary.

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

As of September 30, 2010, we had net deferred tax assets of $36.2 million, including a valuation allowance of $1.3 million established against our state deferred tax asset. This valuation allowance was established due to differences in the carryforward periods in state and federal tax laws. In evaluating the need for a valuation allowance, we estimate future taxable income based on management approved forecasts. This process requires significant judgment by management about matters that are by nature uncertain. If future events differ significantly from our current forecasts, we may need to adjust our valuation allowance, which could materially impact our results of operations and financial condition. For additional information, see Note J (Income Taxes) of the Notes to Consolidated Financial Statements in our December 31, 2009 Form 10-K.

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

Comparison of Results of Operations for the Nine Months Ended September 30, 2010 and 2009

Net Income/(Loss)

For the first nine months of 2010, we reported a net loss of $11.7 million, or $(0.98) per common share, compared to a net loss of $112.2 million, or $(9.42) per common share, for the first nine months of 2009.

Net Interest Income

Net interest income, the primary source of our earnings, represents income generated from earning assets, less the interest expense of funding those assets. Changes in net interest income may be divided into two components: (1) the change in average earning assets (volume component) and (2) the change in the net interest spread (rate component). Net interest spread represents the difference between yields on earning assets and rates paid on interest-bearing liabilities. Net interest margin is net interest income divided by average earning assets.

Net interest income decreased by $4.5 million, or 13.1%, from $34.6 million for the first nine months of 2009 to $30.0 million for the first nine months of 2010. Between the first nine months of 2009 and the first nine months of 2010, the net interest margin declined from 2.47% to 2.33%. During this period, we lost 51 basis points of yield on our earning assets and decreased our cost of funds by 46 basis points.

The declining yield on earning assets is mostly attributable to changes in mix and volumes. Average earning assets declined from $1.875 billion in the first nine months of 2009 to $1.722 billion in the first nine months of 2010. This decline is primarily due to a $245.2 million decrease in average loan balances from the first nine months of 2009 to the first nine months of 2010 and an $84.0 million decrease in average investment securities during the same period. These declines were partially offset by a $177.0 million increase in federal funds sold and other interest-bearing assets, as we intentionally built liquidity by accumulating deposits and investing in short-term assets.

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The decrease in our cost of funds from the first nine months of 2009 to the first nine months of 2010 was impacted by rates and volumes. Our average interest-bearing deposits decreased by $16.3 million from the first nine months of 2009 to the first nine months of 2010, and our deposit cost declined by 49 basis points. Our average balance of other borrowings declined by $81.7 million over this period, and our cost of other borrowings declined by 17 basis points.

The following table shows, for the periods indicated, an analysis of net interest income, including the average amount of earning assets and interest-bearing liabilities outstanding during the period, the interest earned or paid on such amounts, the average yields/rates paid and the net yield on earning assets on both a book and tax equivalent basis:

	Average Balance	
(Dollars in thousands)	**Nine Months Ended 9/30/10**	**Nine Months Ended 9/30/09**
EARNING ASSETS:		
Net loans	$ 1,023,778	$ 1,268,930
Federal funds sold and other interest-bearing assets	334,251	157,216
Securities:		
Taxable	360,763	373,503
Tax-exempt	3,695	74,919
Totals	1,722,487	1,874,568
INTEREST-BEARING LIABILITIES:		
Interest-bearing deposits	1,340,181	1,356,497
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase and other interest-bearing liabilities	210,674	292,357
Totals	1,550,855	1,648,854
Net amounts	$ 171,632	$ 225,714

	Interest for	
(Dollars in thousands)	**Nine Months Ended 9/30/10**	**Nine Months Ended 9/30/09**
EARNING ASSETS:		
Net loans	$ 39,242	$ 47,639
Federal funds sold and other interest-bearing assets	576	273
Securities:		
Taxable	10,698	12,083
Tax-exempt	131	2,250
Totals	50,647	62,245
INTEREST-BEARING LIABILITIES:		
Interest-bearing deposits	16,570	21,690
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase and other interest-bearing liabilities	4,056	5,993

Totals	20,626	27,683
Net amounts	$ 30,021	$ 34,562

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	Yields Earned And Rates Paid (%) Nine Months Ended 9/30/10	Nine Months Ended 9/30/09
EARNING ASSETS:		
Net loans	5.12	5.02
Federal funds sold and other interest-bearing assets	0.23	0.23
Securities:		
Taxable	3.96	4.33
Tax-exempt	4.75	4.01
Totals	3.93	4.44
INTEREST-BEARING LIABILITIES:		
Interest-bearing deposits	1.65	2.14
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase and other interest-bearing liabilities	2.57	2.74
Totals	1.78	2.24

Net amounts