FIRST FINANCIAL BANKSHARES INC
Form 10-K
February 19, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2009

Commission file number 0-7674
First Financial Bankshares, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Texas	**75-0944023**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
400 Pine Street, Abilene, Texas	**79601**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s telephone number, including area code: **(325) 627-7155**

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common Stock, par value $0.01 per share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

As of June 30, 2009, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of voting and non-voting common stock held by non-affiliates was $974,498,000.

As of February 19, 2010, there were 20,840,924 shares of Common Stock outstanding.

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Documents Incorporated by Reference

Certain information called for by Part III is incorporated by reference to the proxy statement for our 2010 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2009.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K contains certain 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. When used in this Form 10-K, words such as anticipate, believe, estimate, expect, intend, predict, project, and similar expressions, as they relate to us o management, identify forward-looking statements. These forward-looking statements are based on information currently available to our management. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including but not limited, to those listed in Item 1A-Risk Factors and the following:

- general economic conditions, including our local and national real estate markets and employment trends;
- volatility and disruption in national and international financial markets;
- legislative, tax and regulatory actions and reforms;
- political instability;
- the ability of the Federal government to deal with the national economic slowdown and the effect of stimulus packages enacted by Congress as well as future stimulus packages, if any;
- competition from other financial institutions and financial holding companies;
- the effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;
- changes in the demand for loans;
- fluctuations in the value of collateral securing our loan portfolio and in the level of the allowance for loan losses;
- the accuracy of our estimates of future loan losses;
- the accuracy of our estimates and assumptions regarding the performance of our securities portfolio;
- soundness of other financial institutions with which we have transactions;
- inflation, interest rate, market and monetary fluctuations;
- changes in consumer spending, borrowing and savings habits;
- continued increases in FDIC deposit insurance assessments;
- our ability to attract deposits;
- consequences of continued bank mergers and acquisitions in our market area, resulting in fewer but much larger and stronger competitors;

expansion of operations, including branch openings, new product offerings and expansion into new markets;

acquisitions and integration of acquired businesses; and

acts of God or of war or terrorism.

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Such statements reflect the current views of our management with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this paragraph. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

General

First Financial Bankshares, Inc., a Texas corporation, is a financial holding company registered under the Bank Holding Company Act of 1956, or BHCA. As such, we are supervised by the Board of Governors of the Federal Reserve System, or Federal Reserve Board, as well as several other state and federal regulators. We were formed as a bank holding company in 1956 under the original name F & M Operating Company, but our banking operations date back to 1890, when Farmers and Merchants National Bank opened for business in Abilene, Texas. Through our wholly-owned Delaware subsidiary, First Financial Bankshares of Delaware, Inc., we own ten banks, a trust company, a technology operating company, and an insurance agency, all organized and located in Texas. These subsidiaries are:

First Financial Bank, National Association, Abilene, Texas;

First Financial Bank, Hereford, Texas;

First Financial Bank, National Association, Sweetwater, Texas;

First Financial Bank, National Association, Eastland, Texas;

First Financial Bank, National Association, Cleburne, Texas;

First Financial Bank, National Association, Stephenville, Texas;

First Financial Bank, National Association, San Angelo, Texas;

First Financial Bank, National Association, Weatherford, Texas;

First Financial Bank, National Association, Southlake, Texas;

First Financial Bank, National Association, Mineral Wells, Texas;

First Technology Services, Inc., Abilene, Texas;

First Financial Trust & Asset Management Company, National Association, Abilene, Texas; and

First Financial Insurance Agency, Inc., Abilene, Texas.

Through our subsidiary banks, we conduct a full-service commercial banking business. Our service centers are located primarily in North Central and West Texas. Considering the branches and locations of all our subsidiaries, as of December 31, 2009, we had 48 financial centers across Texas, with ten locations in Abilene, two locations in Cleburne, three locations in Stephenville, three locations in Granbury, two locations in San Angelo, three locations in Weatherford, and one location each in Mineral Wells, Hereford, Sweetwater, Eastland, Ranger, Rising Star, Southlake, Aledo, Willow Park, Brock, Alvarado, Burleson, Keller, Trophy Club, Boyd, Bridgeport, Decatur, Roby, Trent, Merkel, Clyde, Moran, Albany, Midlothian and Glen Rose.

Even though we operate in a growing number of Texas markets, we continue to believe that decisions are best made at the local level. Accordingly, each of our ten separately chartered banks operates with local boards of directors, local bank presidents and local decision-making. However, we have consolidated many of the backroom operations, such as investment securities, accounting, check processing, technology and employee benefits, which improves each of our subsidiary bank s efficiency and frees management of our subsidiary banks to concentrate on serving the banking needs of their local communities. We call this our one bank, ten charters concept.

In the past, we have chosen to keep our Company focused on the State of Texas, one of the nation s largest, fastest-growing and most economically diverse states. With approximately 24.3 million residents, Texas has more people than any other state except California. The population of Texas grew 16.7 percent from 2000-2008; nearly double the national rate, according to the U.S. Census Bureau. Many of the communities in which we operate are growing faster than the statewide average, as shown below:

Population Growth 2000-2008*

Bridgeport and Wise County	19.9%
Fort Worth/Tarrant County	21.0%
Cleburne, Midlothian and Johnson County	21.1%
Weatherford, Willow Park and Aledo	26.3%
Granbury and Hood County	23.0%
Stephenville and Erath County	8.7%

* Source: U. S. Census Bureau

These economies include dynamic centers of higher education, agriculture, energy and natural resources, healthcare, tourism, retirement living, manufacturing and distribution.

We have also largely foregone the larger metropolitan areas of Texas. We believe our community matters way of doing business works best for us in small and mid-size markets, where we can play a prominent role in the economic, civic and cultural life of the community. Our goal is to serve these communities well and to experience growth as these markets continue to expand. In many instances, banking competition is less intense in smaller markets, making it easier for us to operate rationally and attract and retain high-caliber employees who prefer not only our community-banker concept but the high quality of life in smaller cities.

Over the years, we have grown three ways: by growing our banks internally, by opening new branch locations and by acquisition of other banks. Since the beginning of 1997, we have completed ten bank acquisitions and doubled total assets from $1.57 billion to $3.28 billion. We have also established a trust and asset management company and a technology services company, both of which operate as subsidiaries of First Financial Bankshares, Inc. Looking ahead, we will continue to grow locally by better serving the needs of our customers and putting them first in all of our decisions. We continually look for new branch locations, so we can provide more convenient service to our customers, and we are actively pursuing acquisitions by calling on banks that we would like to acquire, working with brokers and the FDIC.

When targeting a bank for acquisition, the bank generally needs to be in the type of community that fits our profile. We like growing communities with good amenities schools, infrastructure, commerce and lifestyle. We prefer non-metropolitan markets, either within a 50-mile radius of the Dallas/Fort Worth metroplex or along the Interstate 35, 45 and 20 corridors in Texas. We also have an affinity in banks in East Texas and the Texas Hill Country area. Banks in the $100 million to $300 million asset size fit our sweet spot for acquisition, but we will consider banks that are larger or smaller, or that are in other areas of Texas if we believe they would be a good fit for our existing Company.

We also own directly two subsidiaries, First Financial Investments, Inc. (which is dormant) and First Financial Investments of Delaware, Inc.

Information on our revenues, profits and losses and total assets appears in the discussion of our Results of Operations contained in Item 7 hereof.

First Financial Bankshares, Inc.

We provide management and technical resources and policy direction to our subsidiaries, which enable them to improve or expand their banking services while continuing their local activity and identity. Each of our subsidiaries operates under the day-to-day management of its own board of directors and officers, with substantial authority in making decisions concerning their own loan decisions, interest rates, service charges and marketing. We provide resources and policy direction in, among other things, the following areas:

- asset and liability management;
- investments;

accounting;

budgeting;

training;

marketing;

planning;

risk management;

loan review;

human resources;

insurance;

capitalization;

regulatory compliance; and

internal audit.

In particular, we assist our subsidiaries with, among other things, decisions concerning major capital expenditures, employee fringe benefits, including retirement plans and group medical, dividend policies, and appointment of officers and directors and their compensation. We also perform, through corporate staff groups or by outsourcing to third parties, internal audits, compliance oversight and loan reviews of our subsidiaries. We provide advice and specialized services for our banks related to lending, investing, purchasing, advertising, public relations, and computer services.

We evaluate various potential financial institution acquisition opportunities and approve potential locations for new branch offices. We anticipate that funding for any acquisitions or expansions would be provided from our existing cash balances, available dividends from subsidiary banks, utilization of available lines of credit and future debt or equity offerings.

Services Offered by Our Subsidiary Banks

Each of our subsidiary banks is a separate legal entity that operates under the day-to-day management of its own board of directors and officers. Each of our subsidiary banks provides general commercial banking services, which include accepting and holding checking, savings and time deposits, making loans, automated teller machines, drive-in and night deposit services, safe deposit facilities, remote deposit capture, internet banking, transmitting funds, and performing other customary commercial banking services. We also conduct full service trust activities through First Financial Trust & Asset Management Company, National Association. Through our trust company, we administer all types of retirement and employee benefit accounts, which include 401(k) profit sharing plans and IRAs. We also offer personal trust services, which include the administration of estates, testamentary trusts, revocable and irrevocable trusts and agency accounts. In addition, First Financial Bank, National Association, Abilene, First Financial Bank, National Association, San Angelo and First Financial Bank, National Association, Weatherford provide securities brokerage services through arrangements with an unrelated third party.

Competition

Commercial banking in Texas is highly competitive, and because we hold less than 1% of the state s deposits, we represent only a minor segment of the industry. To succeed in this industry, we believe that our banks must have the capability to compete effectively in the areas of (1) interest rates paid or charged; (2) scope of services offered; and (3) prices charged for such services. Our subsidiary banks compete in their respective service areas against highly competitive banks, thrifts, savings and loan associations, small loan companies, credit unions, mortgage companies, insurance companies, and brokerage firms, all of which are engaged in providing financial products and services and some of which are larger than our subsidiary banks in terms of capital, resources and personnel.

Our business does not depend on any single customer or any few customers, the loss of any one of which would have a materially adverse effect upon our business. Although we have a broad base of customers that are not related to us, our customers also occasionally include our officers and directors, as well as other entities with which we are affiliated. Through our subsidiary banks we may make loans to officers and directors, and entities with which we are affiliated, in the ordinary course of business. We make these loans on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. Loans to directors, officers and their affiliates are also subject to numerous restrictions under federal and state banking laws, which we describe in greater detail below.

Employees

With our subsidiary banks, we employed approximately 950 full-time equivalent employees at December 31, 2009. Our management believes that our employee relations have been and will continue to be good.

Supervision and Regulation

Both federal and state laws extensively regulate bank holding companies, financial holding companies and banks. These laws (and the regulations promulgated thereunder) are primarily intended to protect depositors and the deposit insurance fund of the Federal Deposit Insurance Corporation, or FDIC. The following information describes particular laws and regulatory provisions relating to financial holding companies and banks. This discussion is qualified in its entirety by reference to the particular laws and regulatory provisions. A change in any of these laws or regulations may have a material effect on our business and the business of our subsidiary banks.

Bank Holding Companies and Financial Holding Companies

Historically, the activities of bank holding companies were limited to the business of banking and activities closely related or incidental to banking. Bank holding companies were generally prohibited from acquiring control of any company that was not a bank and from engaging in any business other than the business of banking or managing and controlling banks. The Gramm-Leach-Bliley Act, which took effect on March 12, 2000, dismantled many Depression-era restrictions against affiliation between banking, securities and insurance firms by permitting bank holding companies to engage in a broader range of financial activities, so long as certain safeguards are observed. Specifically, bank holding companies may elect to become financial holding companies that may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental to a financial activity. Thus, with the enactment of the Gramm-Leach-Bliley Act, banks, securities firms and insurance companies find it easier to acquire or affiliate with each other and cross-sell financial products. The Act permits a single financial services organization to offer a more complete array of financial products and services than historically was permitted.

A financial holding company is essentially a bank holding company with significantly expanded powers. Under the Gramm-Leach-Bliley Act, in addition to traditional lending activities, the following activities are among those that are deemed financial in nature for financial holding companies: securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, activities which the Federal Reserve Board determines to be closely related to banking, and certain merchant banking activities.

We elected to become a financial holding company in September 2001. As a financial holding company, we have very broad discretion to affiliate with securities firms and insurance companies, make merchant banking investments, and engage in other activities that the Federal Reserve Board has deemed financial in nature. In order to continue as a financial holding company, we must continue to be well-capitalized, well-managed and maintain compliance with the Community Reinvestment Act. Depending on the types of financial activities that we may elect to engage in, under Gramm-Leach-Bliley s functional regulation principles, we may become subject to supervision by additional government agencies. The election to be treated as a financial holding company increases our ability to offer financial products and services that historically we were either unable to provide or were only able to provide on a limited basis. As a result, we will face increased competition in the markets for any new financial products and services that we may offer. Likewise, an increased amount of consolidation among banks and securities firms or banks and insurance firms could result in a growing number of large financial institutions that could compete aggressively with us.

Mergers and Acquisitions

We generally must obtain approval from the banking regulators before we can acquire other financial institutions. We may not engage in certain acquisitions if we are undercapitalized. Furthermore, the BHCA provides that the Federal Reserve Board cannot approve any acquisition, merger or consolidation that may substantially lessen competition in the banking industry, create a monopoly in any section of the country, or be a restraint of trade. However, the Federal Reserve Board may approve such a transaction if the convenience and needs of the community clearly outweigh any anti-competitive effects. Specifically, the Federal Reserve Board would consider, among other factors, the expected benefits to the public (greater convenience, increased competition, greater efficiency, etc.) against the risks of possible adverse effects (undue concentration of resources, decreased or unfair competition, conflicts of interest, unsound banking practices, etc.).

Banks

Federal and state laws and regulations that govern banks have the effect of, among other things, regulating the scope of business, investments, cash reserves, the purpose and nature of loans, the maximum interest rate chargeable on loans, the amount of dividends declared, and required capitalization ratios.

National Banking Associations. Banks organized as national banking associations under the National Bank Act are subject to regulation and examination by the Office of the Comptroller of the Currency, or OCC. The OCC supervises, regulates and regularly examines:

- First Financial Bank, National Association, Abilene;
- First Financial Bank, National Association, Sweetwater;
- First Financial Bank, National Association, Cleburne;
- First Financial Bank, National Association, Eastland;
- First Financial Bank, National Association, San Angelo;
- First Financial Bank, National Association, Weatherford;
- First Financial Bank, National Association, Southlake;
- First Financial Bank, National Association, Stephenville;
- First Financial Bank, National Association, Mineral Wells;
- First Financial Trust & Asset Management Company, National Association; and
- First Technology Services, Inc.

The OCC s supervision and regulation of banks is primarily intended to protect the interests of depositors. The National Bank Act:

- requires each national banking association to maintain reserves against deposits,
- restricts the nature and amount of loans that may be made and the interest that may be charged, and
- restricts investments and other activities.

State Banks. Banks that are organized as state banks under Texas law are subject to regulation and examination by the Banking Commissioner of the State of Texas. The Commissioner regulates and supervises, and the Texas Banking Department regularly examines our one subsidiary state bank, First Financial Bank, Hereford. The Commissioner s supervision and regulation of banks is primarily designed to protect the interests of depositors. Texas law:

- restricts the nature and amount of loans that may be made and the interest that may be charged, and

- restricts investments and other activities.

State banks are also subject to regulation by either the FDIC or the Federal Reserve Board. Because First Financial Bank, Hereford is a non-member bank, it is also regulated by the FDIC and is subject to most of the federal laws described below.

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Deposit Insurance

Each of our subsidiary banks is a member of the FDIC. The FDIC provides deposit insurance protection that covers all deposit accounts in FDIC-insured depository institutions. Until October 2008, the protection generally did not exceed $100,000 per depositor. Beginning in October 2008, the amount of protection was increased to $250,000, under the Temporary Liquidity Guarantee Program (TLGP) of the Emergency Economic Stabilization Act of 2008. This increased protection to $250,000 was initially available only through December 31, 2009 but was extended through December 31, 2013. The new regulations were also expanded whereby the protection for non interest bearing deposits was unlimited at institutions participating in the TLGP. This unlimited coverage for these non interest bearing accounts was also initially only available through December 31, 2009 but was extended until June 30, 2010. Non interest bearing deposits include, by definition, certain Interest on Lawyers Trust Accounts and Negotiable Order of Withdrawal accounts (NOW Accounts) with interest rates no higher than 0.50 percent. All of our subsidiary banks elected to participate in the TLGP.

Our subsidiary banks must pay assessments to the FDIC under a risk-based assessment system for this federal deposit insurance protection. FDIC-insured depository institutions that are members of the Bank Insurance Fund pay insurance premiums at rates based on their risk classification. Institutions assigned to higher risk classifications (i.e., institutions that pose a greater risk of loss to the deposit insurance fund) pay assessments at higher rates than institutions assigned to lower risk classifications. An institution s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to bank regulators. In addition, the FDIC can impose special assessments to cover the costs of borrowings from the U.S. Treasury, the Federal Financing Bank and the Deposit Insurance Fund member banks. In the second quarter of 2009, the FDIC made a special assessment equal to 0.05 percent of total assets less Tier 1 Capital. The assessment totaled $1.4 million in the aggregate for our subsidiary banks, and was paid on September 30, 2009. As of December 31, 2009, the assessment rate for each of our subsidiary banks was at the lowest level risk-based premium available which was 0.12 percent of deposits per annum less applicable credits (with the exception of First Financial Bank, N.A., Southlake whose rate was 0.141 percent of deposits per annum and First Financial Bank, N.A., Stephenville whose rate was 0.124 percent of deposits per annum). In addition, we must pay an additional assessment of 0.10 percent per annum of the amount of noninterest bearing deposits, as defined, greater than $250,000. The FDIC also announced in 2009 the requirement of member banks to prepay on December 30, 2009, their estimated quarterly assessments for 2010, 2011 and 2012, including a three basis point increase in premium rates for 2011 and 2012. The Company s prepayment amount totaled $11.6 million in the aggregate and will be expensed over a three year period based on future quarterly assessment calculations.

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, or FIRREA, an FDIC-insured depository institution can be held liable for any losses incurred by the FDIC in connection with (1) the default of one of its FDIC-insured subsidiaries or (2) any assistance provided by the FDIC to one of its FDIC-insured subsidiaries in danger of default. Default is defined generally as the appointment of a conservator or receiver, and in danger of default is defined generally as the existence of certain conditions indicating that a default is likely to occur in the absence of regulatory assistance.

The Federal Deposit Insurance Act, or FDIA, requires that the FDIC review (1) any merger or consolidation by or with an insured bank, or (2) any establishment of branches by an insured bank. The FDIC is also empowered to regulate interest rates paid by insured banks. Approval of the FDIC is also required before an insured bank retires any part of its common or preferred stock, or any capital notes or debentures.

Payment of Dividends

We are a legal entity separate and distinct from our banking and other subsidiaries. We receive most of our revenue from dividends paid to us by our Delaware holding company subsidiary. Similarly, the Delaware holding company subsidiary receives dividends from our banking and other subsidiaries. Described below are some of the laws and regulations that apply when either we or our subsidiary banks pay dividends.

Each of our national bank subsidiaries is required by federal law to obtain the prior approval of the OCC to declare and pay dividends if the total of all dividends declared in any calendar year would exceed the total of (1)

such bank s net profits (as defined and interpreted by regulation) for that year plus (2) its retained net profits (as defined and interpreted by regulation) for the preceding two calendar years, less any required transfers to surplus. In addition, these banks may only pay dividends to the extent that retained net profits (including the portion transferred to surplus) exceed bad debts (as defined by regulation). First Financial Bank, Hereford, as a Texas state banking association, may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commission. In additional, the FDIC has the right to prohibit the payment of dividends by a state, non-member bank where the payment is deemed to be an unsafe or unsound banking practice.

Our subsidiaries paid aggregate dividends of approximately $37.8 million in 2009 and approximately $39.7 million in 2008. Under the dividend restrictions discussed above, as of December 31, 2009, our subsidiary banks could have declared in the aggregate additional dividends of approximately $40.6 million from retained net profits, without obtaining regulatory approvals.

To pay dividends, we and our subsidiary banks must maintain adequate capital above regulatory guidelines. In addition, if the applicable regulatory authority believes that a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), the authority may require, after notice and hearing, that such bank cease and desist from the unsafe practice. The FDIC and the OCC have each indicated paying dividends that deplete a bank s capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve Board, the OCC and the FDIC have issued policy statements that recommend that bank holding companies and insured banks should generally only pay dividends to the extent net income is sufficient to cover both cash dividends and a rate of earnings retention consistent with capital needs, asset quality and overall financial condition. No undercapitalized institution may pay a dividend.

Affiliate Transactions

The Federal Reserve Act, the FDIA and the rules adopted under these statutes restrict the extent to which we can borrow or otherwise obtain credit from, or engage in certain other transactions with, our depository subsidiaries. These laws regulate covered transactions between insured depository institutions and their subsidiaries, on the one hand, and their nondepository affiliates, on the other hand. Covered transactions include a loan or extension of credit to a nondepository affiliate, a purchase of securities issued by such an affiliate, a purchase of assets from such an affiliate (unless otherwise exempted by the Federal Reserve Board), an acceptance of securities issued by such an affiliate as collateral for a loan, and an issuance of a guarantee, acceptance, or letter of credit for the benefit of such an affiliate. The covered transactions that an insured depository institution and its subsidiaries are permitted to engage in with their nondepository affiliates are limited to the following amounts: (1) in the case of any one such affiliate, the aggregate amount of covered transactions cannot exceed ten percent of the capital stock and the surplus of the insured depository institution; and (2) in the case of all affiliates, the aggregate amount of covered transactions cannot exceed twenty percent of the capital stock and surplus of the insured depository institution. In addition, extensions of credit that constitute covered transactions must be collateralized in prescribed amounts. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. Finally, when we and our subsidiary banks conduct transactions internally among us, we are required to do so at arm s length.

Loans to Directors, Executive Officers and Principal Shareholders

The authority of our subsidiary banks to extend credit to our directors, executive officers and principal shareholders, including their immediate family members and corporations and other entities that they control, is subject to substantial restrictions and requirements under Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder, as well as the Sarbanes-Oxley Act of 2002. These statutes and regulations impose specific limits on the amount of loans our subsidiary banks may make to directors and other insiders, and specified approval procedures must be followed in making loans that exceed certain amounts. In addition, all loans our subsidiary banks make to directors and other insiders must satisfy the following requirements:

- the loans must be made on substantially the same terms, including interest rates and collateral, as prevailing at the time for comparable transactions with persons not affiliated with us or the subsidiary banks;

the subsidiary banks must follow credit underwriting procedures at least as stringent as those applicable to comparable transactions with persons who are not affiliated with us or the subsidiary banks; and

the loans must not involve a greater than normal risk of non-payment or include other features not favorable to the bank.

Furthermore, each subsidiary bank must periodically report all loans made to directors and other insiders to the bank regulators, and these loans are closely scrutinized by the regulators for compliance with Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O. Each loan to directors or other insiders must be pre-approved by the bank s board of directors with the interested director abstaining from voting.

Capital

Bank Holding Companies and Financial Holding Companies. The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies and financial holding companies. The ratio of total capital to risk weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) must be a minimum of eight percent. At least half of the total capital is to be composed of common shareholders equity, minority interests in the equity accounts of consolidated subsidiaries and a limited amount of perpetual preferred stock, less goodwill, which is collectively referred to as Tier 1 Capital. The remainder of total capital may consist of subordinated debt, other preferred stock and a limited amount of loan loss reserves.

In addition, the Federal Reserve Board has established minimum leverage ratio guidelines for bank holding companies and financial holding companies. Bank holding companies and financial holding companies that meet certain specified criteria, including having the highest regulatory rating, must maintain a minimum Tier 1 Capital leverage ratio (Tier 1 Capital to average assets for the current quarter, less goodwill) of three percent. Bank holding companies and financial holding companies that do not have the highest regulatory rating will generally be required to maintain a higher Tier 1 Capital leverage ratio of three percent plus an additional cushion of 100 to 200 basis points. The guidelines also provide that bank holding companies and financial holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions. Such strong capital positions must be kept substantially above the minimum supervisory levels without significant reliance on intangible assets (e.g., goodwill and core deposit intangibles). As of December 31, 2009, our capital ratios were as follows: (1) Tier 1 Capital to Risk-Weighted Assets Ratio, 17.73%; (2) Total Capital to Risk-Weighted Assets Ratio, 18.99%; and (3) Tier 1 Capital Leverage Ratio, 10.69%.

Banks. The Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, established five capital tiers with respect to depository institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. A depository institution s capital tier will depend upon where its capital levels are in relation to various relevant capital measures, including (1) risk-based capital measures, (2) a leverage ratio capital measure and (3) certain other factors. Regulations establishing the specific capital tiers provide that a well-capitalized institution will have a total risk-based capital ratio of ten percent or greater, a Tier 1 risk-based capital ratio of six percent or greater, and a Tier 1 leverage ratio of five percent or greater, and not be subject to any written regulatory enforcement agreement, order, capital directive or prompt corrective action derivative. For an institution to be adequately capitalized, it will have a total risk-based capital ratio of eight percent or greater, a Tier 1 risk-based capital ratio of four percent or greater, and a Tier 1 leverage ratio of four percent or greater (in some cases three percent). For an institution to be undercapitalized, it will have a total risk-based capital ratio that is less than eight percent, a Tier 1 risk-based capital ratio less than four percent or a Tier 1 leverage ratio less than four percent (or a leverage ratio less than three percent if the institution s composite rating is 1 in its most recent report of examination, subject to appropriate federal banking agency guidelines). For an institution to be significantly undercapitalized, it will have a total risk-based capital ratio less than six percent, a Tier 1 risk-based capital ratio less than three percent, or a Tier 1 leverage ratio less than three percent. For an institution to be critically undercapitalized, it will have a ratio of tangible equity to total assets equal to or less than two percent. FDICIA requires federal banking agencies to take prompt corrective action against depository institutions that do not meet minimum capital requirements. Under current regulations, all of our subsidiary banks were well capitalized as of December 31, 2009.

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FDICIA generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. An undercapitalized institution must develop a capital restoration plan and its parent holding company must guarantee that institution s compliance with such plan. The liability of the parent holding company under any such guarantee is limited to the lesser of five percent of the institution s assets at the time it became undercapitalized or the amount needed to bring the institution into compliance with all capital standards. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent s general unsecured creditors. If a depository institution fails to submit an acceptable capital restoration plan, it shall be treated as if it is significantly undercapitalized. Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator. Finally, FDICIA requires the various regulatory agencies to set forth certain standards that do not relate to capital. Such standards relate to the safety and soundness of operations and management and to asset quality and executive compensation, and permit regulatory action against a financial institution that does not meet such standards.

If an insured bank fails to meet its capital guidelines, it may be subject to a variety of other enforcement remedies, including a prohibition on the taking of brokered deposits and the termination of deposit insurance by the FDIC. Bank regulators continue to indicate their desire to raise capital requirements beyond their current levels.

In addition to FDICIA capital standards, Texas-chartered banks must also comply with the capital requirements imposed by the Texas Banking Department. Neither the Texas Finance Code nor its regulations specify any minimum capital-to-assets ratio that must be maintained by a Texas-chartered bank. Instead, the Texas Banking Department determines the appropriate ratio on a bank by bank basis, considering factors such as the nature of a bank s business, its total revenue, and the bank s total assets. As of December 31, 2009, our Texas-chartered bank exceeded the minimum ratios applied to it.

Our Support of Our Subsidiary Banks

Under Federal Reserve Board policy, we are expected to commit resources to act as a source of strength to support each of our subsidiary banks. This support may be required at times when, absent such Federal Reserve Board policy, we would not otherwise be required to provide it. In addition, any loans we make to our subsidiary banks would be subordinate in right of payment to deposits and to other indebtedness of our banks. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and be subject to a priority of payment.

Under the National Bank Act, if the capital stock of a national bank is impaired by losses or otherwise, the OCC is authorized to require the bank s shareholders to pay the deficiency on a pro-rata basis. If any shareholder refuses to pay the pro-rata assessment after three months notice, then the bank s board of directors must sell an appropriate amount of the shareholder s stock at a public auction to make up the deficiency. To the extent necessary, if a deficiency in capital still exists and the bank refuses to go into liquidation, then a receiver may be appointed to wind down the bank s affairs. Additionally, under the Federal Deposit Insurance Act, in the event of a loss suffered or anticipated by the FDIC (either as a result of the default of a banking subsidiary or related to FDIC assistance provided to a subsidiary in danger of default) our other banking subsidiaries may be assessed for the FDIC s loss.

Interstate Banking and Branching Act

Pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, or Riegle-Neal Act, a bank holding company or financial holding company is able to acquire banks in states other than its home state. The Riegle-Neal Act also authorized banks to merge across state lines, thereby creating interstate branches. Furthermore, under this act, a bank is also able to open new branches in a state in which it does not already have banking operations, if the laws of such state permit it to do so. Accordingly, both the OCC and the Texas Banking Department accept applications for interstate merger and branching transactions, subject to certain limitations on ages of the banks to be acquired and the total amount of deposits within the state a bank or financial holding company may control. Since our primary service area is Texas, we do not expect that the ability to operate in other states will have any material impact on our growth strategy. We may, however, face increased competition from out-of-state banks that branch or make acquisitions in our primary markets in Texas.

Community Reinvestment Act of 1977

The Community Reinvestment Act of 1977, or CRA, subjects a bank to regulatory assessment to determine if the institution meets the credit needs of its entire community, including low- and moderate-income neighborhoods served by the bank, and to take that determination into account in its evaluation of any application made by such bank for, among other things, approval of the acquisition or establishment of a branch or other deposit facility, an office relocation, a merger, or the acquisition of shares of capital stock of another financial institution. The regulatory authority prepares a written evaluation of an institution s record of meeting the credit needs of its entire community and assigns a rating. These ratings are Outstanding , Satisfactory , Needs Improvement and Substantial Non-Compliance. Institutions with ratings lower than Satisfactory may be restricted from engaging in the aforementioned activities. We believe our subsidiary banks have taken significant actions to comply with the CRA, and each has received ratings ranging from satisfactory to outstanding in its most recent review by federal regulators with respect to its compliance with the CRA.

Monitoring and Reporting Suspicious Activity

Under the Bank Secrecy Act, IRS rules and other regulations, we are required to monitor and report unusual or suspicious account activity as well as transactions involving the transfer or withdrawal of amounts in excess of prescribed limits. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are also required to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;
- an ongoing employee training program; and
- an independent audit function to test the programs.

In addition, under the USA PATRIOT Act, the Secretary of the Treasury has adopted rules addressing a number of related issues, including increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to violate the privacy provisions of the Gramm-

Leach-Bliley Act that are discussed below. Finally, under the regulations of the Office of Foreign Asset Control, we are required to monitor and block transactions with certain specially designated nationals who OFAC has determined pose a risk to U.S. national security.

Consumer Laws and Regulations

We are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the following list is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, The Fair and Accurate Credit Transactions Act, The Real Estate Settlement Procedures Act and the Fair Housing Act, among others. These laws and regulations, among other things, prohibit discrimination on the basis of race, gender or other designated characteristics and mandate various disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. These and other laws also limit finance charges or other fees or charges earned in our activities. We must comply with the applicable provisions of these consumer protection laws and regulations as part of our ongoing customer relations.

Technology Risk Management and Consumer Privacy

State and federal banking regulators have issued various policy statements emphasizing the importance of technology risk management and supervision in evaluating the safety and soundness of depository institutions with respect to banks that contract with outside vendors to provide data processing and core banking functions. The use of technology-related products, services, delivery channels and processes exposes a bank to various risks, particularly operational, privacy, security, strategic, reputation and compliance risk. Banks are generally expected to prudently manage technology-related risks as part of their comprehensive risk management policies by identifying, measuring, monitoring and controlling risks associated with the use of technology.

Under Section 501 of the Gramm-Leach-Bliley Act, the federal banking agencies have established appropriate standards for financial institutions regarding the implementation of safeguards to ensure the security and confidentiality of customer records and information, protection against any anticipated threats or hazards to the security or integrity of such records and protection against unauthorized access to or use of such records or information in a way that could result in substantial harm or inconvenience to a customer. Among other matters, the rules require each bank to implement a comprehensive written information security program that includes administrative, technical and physical safeguards relating to customer information.

Under the Gramm-Leach-Bliley Act, a financial institution must also provide its customers with a notice of privacy policies and practices. Section 502 prohibits a financial institution from disclosing nonpublic personal information about a customer to nonaffiliated third parties unless the institution satisfies various notice and opt-out requirements and the customer has not elected to opt out of the disclosure. Under Section 504, the agencies are authorized to issue regulations as necessary to implement notice requirements and restrictions on a financial institution s ability to disclose nonpublic personal information about customers to nonaffiliated third parties. Under the final rule the regulators adopted, all banks must develop initial and annual privacy notices which describe in general terms the bank s information sharing practices. Banks that share nonpublic personal information about customers with nonaffiliated third parties must also provide customers with an opt-out notice and a reasonable period of time for the customer to opt out of any such disclosure (with certain exceptions). Limitations are placed on the extent to which a bank can disclose an account number or access code for credit card, deposit or transaction accounts to any nonaffiliated third party for use in marketing.

Monetary Policy

Banks are affected by the credit policies of monetary authorities, including the Federal Reserve Board, that affect the national supply of credit. The Federal Reserve Board regulates the supply of credit in order to influence general economic conditions, primarily through open market operations in United States government obligations, varying the discount rate on financial institution borrowings, varying reserve requirements against financial institution deposits, and restricting certain borrowings by financial institutions and their subsidiaries. The monetary

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policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future.

Pending and Proposed Legislation

New regulations and statutes are regularly proposed containing wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating in the United States. We cannot predict whether, or in what form, any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

Enforcement Powers of Federal Banking Agencies

The Federal Reserve and other state and federal banking agencies and regulators have broad enforcement powers, including the power to terminate deposit insurance, issue cease-and-desist orders, impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver. Our failure to comply with applicable laws, regulations and other regulatory pronouncements could subject us, as well as our officers and directors, to administrative sanctions and potentially substantial civil penalties.

Recent Developments

The U. S. and global economies have experienced and are experiencing significant stress and disruptions in the financial sector. Dramatic slowdowns in the housing industry with falling home prices and increasing foreclosures and unemployment have created strains on financial institutions, including government-sponsored entities and investment banks. As a result, many financial institutions sought and continue to seek additional capital, merge or seek mergers with larger and stronger institutions and, in some cases, failed.

In response to the financial crisis affecting the banking and financial markets, in October 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Pursuant to the EESA, the U.S. Treasury (the Treasury) has the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U. S. financial markets.

In addition, the Treasury was authorized to purchase equity stakes in U. S. financial institutions. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program), from the $700 billion authorized by the EESA, the Treasury made $250 billion of capital available to U.S. financial institutions through the purchase of preferred stock or subordinated debentures by the Treasury. In conjunction with the purchase of preferred stock from publicly-held financial institutions, the Treasury received warrants to purchase common stock with an aggregate market price equal to 15% of the total amount of the preferred investment. Participating financial institutions were required to adopt the Treasury s standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program and were restricted from increasing dividends to common shareholders or repurchasing common stock for three years without the consent of the Treasury.

Further, after receiving a recommendation from the boards of the FDIC and the Federal Reserve Board, the Treasury signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction deposit accounts under the TLGP. Coverage under the TLGP was available for 30 days without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits above the deposit insurance limit.

The Company made a decision to not participate in the TARP Capital Purchase Program due to its capital and liquidity positions. The Company opted out of the debt guarantee portion of the Temporary Liquidity Guarantee Program but decided to be included in the non-interest bearing deposit account guarantee portion.

Available Information

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document we file at the Securities and Exchange Commission s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public at the Securities and Exchange Commission s web site at http://www.sec.gov. Our web site is http://www.ffin.com. You may also obtain copies of our annual, quarterly and special reports, proxy statements and certain other information filed with the SEC, as well as amendments thereto, free of charge from our web site. These documents are posted to our web site after we have filed them with the SEC. Our corporate governance guidelines, including our code of conduct applicable to all our employees, officers and directors, as well as the charters of our audit and nominating committees, are available at www.ffin.com. The foregoing information is also available in print to any shareholder who requests it. Except as explicitly provided, information on any web site is not incorporated into this Form 10-K or our other securities filings and is not a part of them.

ITEM 1A. RISK FACTORS

Our business, financial condition, operating results and cash flows can be impacted by a number of factors, including but not limited to those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results and other forward-looking statements that we make from time to time in our news releases, annual reports and other written communications, as well as oral forward-looking statements, and other statements made from time to time by our representatives.

Our business faces unpredictable economic conditions, which could have an adverse effect on us.

General economic conditions impact the banking industry. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we conduct our business. Our continued financial success depends somewhat on factors beyond our control, including:

- general economic conditions, including national and local real estate markets;
- the supply of and demand for investable funds;
- demand for loans and access to credit;
- interest rates; and
- federal, state and local laws affecting these matters.

Any substantial deterioration in any of the foregoing conditions could have a material adverse effect on our financial condition, results of operations and liquidity, which would likely adversely affect the market price of our common stock.

In our business, we must effectively manage our credit risk.

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs to dispose of the collateral. We may experience significant loan losses, which could have a material adverse effect on our operating results and financial condition. Management makes various assumptions and judgments about the collectibility of our loan portfolio, including the diversification by industry of our commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume, growth and composition of our loan portfolio, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers and the evaluation of our loan portfolio through our internal loan review process and other relevant factors.

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We maintain an allowance for credit losses, which is an allowance established through a provision for loan losses charged to expense that represents management s best estimate of probable losses inherent in our loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than we have experienced to date. In determining the amount of the allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to the allowance could materially decrease our net income.

In addition, federal and state regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or recognize further charge-offs, based on judgments different than those of our management. Any increase in our allowance for credit losses or charge-offs as required by these regulatory agencies could have a material negative effect on our operating results, financial condition and liquidity.

Our business is concentrated in Texas and a downturn in the economy of Texas may adversely affect our business.

Our network of subsidiary banks is concentrated in Texas, primarily in the Western and North Central regions of the state. Most of our customers and revenue are derived from this area. The economy of this region is focused on agriculture (including farming and ranching), commercial and industrial, medical, education, wind energy, manufacturing, service, oil and gas production, and real estate. Because we generally do not derive revenue or customers from other parts of the state or nation, our business and operations are dependent on economic conditions in this part of Texas. Any significant decline in one or more segments of the local economy could adversely affect our business, revenue, operations and properties.

Changes in economic conditions could cause an increase in delinquencies and non-performing assets, including loan charge-offs, which could depress our net income and growth.

Our loan portfolios include many real estate secured loans, demand for which may decrease during economic downturns as a result of, among other things, an increase in unemployment, a decrease in real estate values and, a slowdown in housing. If we continue to see negative economic conditions in the United States as a whole or in the portions of Texas that we serve, we could experience higher delinquencies and loan charge-offs, which would reduce our net income and adversely affect our financial condition. Furthermore, to the extent that real estate collateral is obtained through foreclosure, the costs of holding and marketing the real estate collateral, as well as the ultimate values obtained from disposition, could reduce our earnings and adversely affect our financial condition.

The value of real estate collateral may fluctuate significantly resulting in an under-collateralized loan portfolio.

The market value of real estate, particularly real estate held for investment, can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. If the value of the real estate serving as collateral for our loan portfolio were to decline materially, a significant part of our loan portfolio could become under-collateralized. If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then, in the event of foreclosure, we may not be able to realize the amount of collateral that we anticipated at the time of originating the loan. This could have a material adverse effect on our provision for loan losses and our operating results and financial condition.

We do business with other financial institutions that could experience financial difficulty.

We do business through the purchase and sale of Federal funds, check clearing and through the purchase and sale of loan participations with other financial institutions. Because these financial institutions have many risks, as do we, we could be adversely effected should one of these financial institutions experience significant financial difficulties or fail to comply with our agreements with them.

Recent developments in the mortgage market may affect our ability to originate loans and the profitability of loans in our mortgage pipeline.

During the past several years, the real estate housing market throughout the United States has softened resulting in an industry-wide increase in borrowers unable to make their mortgage payments and increased foreclosure rates.

Lenders in certain sections of the housing and mortgage markets were forced to close or limit their operations or seek additional capital. In response, financial institutions have tightened their underwriting standards, limiting the availability of sources of credit and liquidity. If the housing/real estate market continues to have problems in the future, there could be a prolonged decrease in the demand for our loans in the secondary market, adversely affecting our earnings.

If we are unable to continue to originate residential real estate loans and sell them into the secondary market for a profit, our earnings could decrease.

We derive a portion of our noninterest income from the origination of residential real estate loans and the subsequent sale of such loans into the secondary market. If we are unable to continue to originate and sell residential real estate loans at historical or greater levels, our residential real estate loan volume would decrease, which could decrease our earnings. A rising interest rate environment, general economic conditions or other factors beyond our control could adversely affect our ability to originate residential real estate loans. We also are experiencing an increase in regulations and compliance requirements related to mortgage loan originations necessitating technology upgrades and other changes. If new regulations continue to increase and we are unable to make technology upgrades, our ability originate mortgage loans will be reduced or eliminated. Additionally, we sell a large portion of our residential real estate loans to third party investors, and rising interest rates could negatively affect our ability to generate suitable profits on the sale of such loans. If interest rates increase after we originate the loans, our ability to market those loans is impaired as the profitability on the loans decreases. These fluctuations can have an adverse effect on the revenue we generate from residential real estate loans and in certain instances, could result in a loss on the sale of the loans.

We may need to raise additional capital/liquidity and such funds may not be available when needed.

We may need to raise additional capital/liquidity in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Our ability to raise additional capital/liquidity, if needed, will depend on, among other things, conditions in the capital and financial markets at that time, which are outside of our control, and our financial performance. Economic conditions and the loss of confidence in financial institutions may increase our cost of funding and limit access to certain customary sources of capital/liquidity, including depositors, other financial institution borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve. Any occurrence that may limit our access to the capital/liquidity markets, such as a decline in the confidence of other financial institutions, depositors or counterparties participating in the capital markets, may adversely affect our costs and our ability to raise capital/liquidity. An inability to raise additional capital/liquidity on acceptable terms when needed could have a materially adverse effect on our financial condition, results of operations and liquidity.

The trust wealth management fees we receive may decrease as a result of poor investment performance, in either relative or absolute terms, which could decrease our revenues and net earnings.

Our trust company subsidiary derives its revenues primarily from investment management fees based on assets under management. Our ability to maintain or increase assets under management is subject to a number of factors, including investors perception of our past performance, in either relative or absolute terms, market and economic conditions, including changes in oil and gas prices, and competition from investment management companies. Financial markets are affected by many factors, all of which are beyond our control, including general economic conditions, including changes in oil and gas prices; securities market conditions; the level and volatility of interest rates and equity prices; competitive conditions; liquidity of global markets; international and regional political conditions; regulatory and legislative developments; monetary and fiscal policy; investor sentiment; availability and cost of capital; technological changes and events; outcome of legal proceedings; changes in currency values; inflation; credit ratings; and the size, volume and timing of transactions. A decline in the fair value of the assets under management caused by a decline in general economic conditions would decrease our wealth management fee income.

Investment performance is one of the most important factors in retaining existing clients and competing for new wealth management clients. Poor investment performance could reduce our revenues and impair our growth in the following ways:

existing clients may withdraw funds from our wealth management business in favor of better performing products;

asset-based management fees could decline from a decrease in assets under management;

our ability to attract funds from existing and new clients might diminish; and

our wealth managers and investment advisors may depart, to join a competitor or otherwise.

Even when market conditions are generally favorable, our investment performance may be adversely affected by the investment style of our wealth management and investment advisors and the particular investments that they make. To the extent our future investment performance is perceived to be poor in either relative or absolute terms, the revenues and profitability of our wealth management business will likely be reduced and our ability to attract new clients will likely be impaired. As such, fluctuations in the equity and debt markets can have a direct impact upon our net earnings.

Certain of our investment advisory and wealth management contracts are subject to termination on short notice, and termination of a significant number of investment advisory contracts could have a material adverse impact on our revenue.

Certain of our investment advisory and wealth management clients can terminate their relationships with us, reduce their aggregate assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, inflation, changes in investment preferences of clients, changes in our reputation in the marketplace, change in management or control of clients, loss of key investment management personnel and financial market performance. We cannot be certain that our trust company subsidiary will be able to retain all of its clients. If its clients terminate their investment advisory and wealth management contracts, our trust company subsidiary, and consequently we, could lose a substantial portion of our revenues.

Our business is subject to significant government regulation.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Texas Department of Banking, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law.

As a result, future legislation and government policy could adversely affect the banking industry as a whole, including our results of operations. For example, new legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, assess fees, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads.

Our FDIC insurance assessments are expected to increase substantially resulting in higher operating costs.

In the past several years, the FDIC announced significant increases in the premiums charged for FDIC deposit insurance protection. We have historically paid the lowest premium rate available due to our sound financial position. In 2009, a special assessment ($1.4 million for the Company) was paid by the Company. Should more bank failures occur, FDIC premiums could continue to increase. This increased premium will have an adverse effect on our net income and results of operations.

We compete with many larger financial institutions which have substantially greater financial resources than we have.

Competition among financial institutions in Texas is intense. We compete with other bank holding companies, state and national commercial banks, savings and loan associations, consumer financial companies, credit unions,

securities brokers, insurance companies, mortgage banking companies, money market mutual funds, asset-based non-bank lenders and other financial institutions. Many of these competitors have substantially greater financial resources, larger lending limits, larger branch networks and less regulatory oversight than we do, and are able to offer a broader range of products and services than we can. Failure to compete effectively for deposit, loan and other banking customers in our markets could cause us to lose market share, slow our growth rate and may have an adverse effect on our financial condition, results of operations and liquidity.

We are subject to interest rate risk.

Our profitability is dependent to a large extent on our net interest income, which is the difference between interest income we earn as a result of interest paid to us on loans and investments and interest we pay to third parties such as our depositors and those from whom we borrow funds. Like most financial institutions, we are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of the Corporation s securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and investments, our net interest income, and earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although we have implemented strategies which we believe reduce the potential effects of adverse changes in interest rates on our results of operations, these strategies may not always be successful. In addition, any substantial and prolonged increase in market interest rates could reduce our customers desire to borrow money from us or adversely affect their ability to repay their outstanding loans by increasing their credit costs since most of our loans have adjustable interest rates that reset periodically. Any of these events could adversely affect our results of operations, financial condition and liquidity.

First Financial Bankshares, Inc. relies on dividends from its subsidiaries for most of its revenue.

First Financial Bankshares, Inc. is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends paid by its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company s common stock and interest and principal on First Financial Bankshares, Inc. debt (if we had balances outstanding). Various federal and/or state laws and regulations limit the amount of dividends that our bank subsidiaries may pay to First Financial Bankshares, Inc. In the event our bank subsidiaries are unable to pay dividends to First Financial Bankshares, Inc., First Financial Bankshares, Inc. may not be able to service debt or pay dividends on the Company s common stock. The inability to receive dividends from our bank subsidiaries could have a material adverse effect on the Company s business, financial condition, results of operations and liquidity.

To continue our growth, we are affected by our ability to identify and acquire other financial institutions.

We intend to continue our current growth strategy. This strategy includes opening new branches and acquiring other banks that serve customers or markets we find desirable. The market for acquisitions remains highly competitive, and we may be unable to find satisfactory acquisition candidates in the future that fit our acquisition and growth strategy. To the extent that we are unable to find suitable acquisition candidates, an important component of our growth strategy may be lost. Additionally, our completed acquisitions, or any future acquisitions, may not produce the revenue, earnings or synergies that we anticipated.

Use of our common stock for future acquisitions or to raise capital may be dilutive to existing stockholders.

When we determine that appropriate strategic opportunities exist, we may acquire other financial institutions and related businesses, subject to applicable regulatory requirements. We may use our common stock for such acquisitions. From time to time, we may also seek to raise capital through selling additional common stock. It is possible that the issuance of additional common stock in such acquisition or capital transactions may be dilutive to the interests of our existing stockholders.

Our operational and financial results are affected by our ability to successfully integrate our acquisitions.

Acquisitions of financial institutions involve operational risks and uncertainties and acquired companies may have unforeseen liabilities, exposure to asset quality problems, key employee and customer retention problems and other problems that could negatively affect our organization. We may not be able to successfully integrate the operations, management, products and services of the entities that we acquire nor eliminate redundancies. The integration process may also require significant time and attention from our management that they would otherwise direct at servicing existing business and developing new business. Our failure to successfully integrate the entities we acquire into our existing operations may increase our operating costs significantly and adversely affect our business and earnings.

We rely heavily on our management team, and the unexpected loss of key management may adversely affect our operations.

Our success to date has been strongly influenced by our ability to attract and to retain senior management experienced in banking in the markets we serve. Our ability to retain executive officers and the current management teams will continue to be important to successful implementation of our strategies. We do not have employment agreements with these key employees other than executive agreements in the event of a change of control and a confidential information, non-solicitation and non-competition agreement related to our stock options. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

The Company may not be able to attract and retain skilled people.

The Company s success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Corporation s key personnel could have a material adverse impact on the Company s business because of their skills, knowledge of the Company s market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

The Company s stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. The Company s stock price can fluctuate significantly in response to a variety of factors including, among other things:

- actual or anticipated variations in quarterly results of operations;
- recommendations by securities analysts;
- operating and stock price performance of other companies that investors deem comparable to the Company;
- new reports relating to trends, concerns and other issues in the financial services industry;
- perceptions in the marketplace regarding the Company and/or its competitors;
- new technology used, or services offered, by competitors;
- significant acquisitions or business combinations involving the Company or its competitors; and
- changes in government regulations.

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General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends could also cause the Company s stock price to decrease regardless of operations results.

Breakdowns in our internal controls and procedures could have an adverse effect on us.

We believe our internal control system as currently documented and functioning is adequate to provide reasonable assurance over our internal controls. Nevertheless, because of the inherent limitation in administering a cost effective control system, misstatements due to error or fraud may occur and not be detected. Breakdowns in our internal controls and procedures could occur in the future, and any such breakdowns could have an adverse effect on us. See Item 9A Controls and Procedures for additional information.

We compete in an industry that continually experiences technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to improving the ability to serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for conveniences, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon our ability to protect the computer systems and network infrastructure utilized by us, including our Internet banking activities, against damage from physical break-ins, security breaches and other disruptive problems caused by the Internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us, damage our reputation and inhibit current and potential customers from our Internet banking services.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this Risk Factors section and elsewhere in this Report. As a result, if you acquire our common stock, you may lose some or all of your investment.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal office is located in the First Financial Bank Building at 400 Pine Street in downtown Abilene, Texas. We lease two spaces in a building owned by First Financial Bank, National Association, Abilene totaling approximately 4,500 square feet and are on a month-to-month basis. Our subsidiary banks collectively own 40 banking facilities, some of which are detached drive-ins, and also lease ten banking facilities and 13 ATM locations.

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Our management considers all our existing locations to be well-suited for conducting the business of banking. We believe our existing facilities are adequate to meet our requirements and our subsidiary banks requirements for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

From time to time we and our subsidiary banks are parties to lawsuits arising in the ordinary course of our banking business. However, there are no material pending legal proceedings to which we, our subsidiary banks or our other direct and indirect subsidiaries, or any of their properties, are currently subject. Other than regular, routine examinations by state and federal banking authorities, there are no proceedings pending or known to be contemplated by any governmental authorities.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of our fiscal year ended December 31, 2009.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock, par value $0.01 per share, is traded on the Nasdaq Global Select Market under the trading symbol FFIN. See Item 8 Financial Statements and Supplementary Data Quarterly Financial Data for the high, low and closing sales prices as reported by the Nasdaq National Market for our common stock for the periods indicated.

Record Holders

As of February 1, 2010, we had approximately 1,400 shareholders of record.

Dividends

See Item 8 Financial Statements and Supplementary Data Quarterly Results of Operations for the frequency and amount of cash dividends paid by us. Also, see Item 1 Business Supervision and Regulation Payment of Dividends and Item 7 Management s Discussion and Analysis of the Financial Condition and Results of Operations Liquidity Dividends for restrictions on our present or future ability to pay dividends, particularly those restrictions arising under federal and state banking laws.

Equity Compensation Plans

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters .

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PERFORMANCE GRAPH

The following performance graph compares cumulative total shareholder returns for our common stock, the Russell 3000 Index, and the SNL Bank Index, which is a banking index prepared by SNL Financial LC and is comprised of banks with $1 billion to $5 billion in total assets, for a five-year period (December 31, 2004 to December 31, 2009). The performance graph assumes $100 invested in our common stock at its closing price on December 31, 2004, and in each of the Russell 3000 Index and the SNL Bank Index on the same date. The performance graph also assumes the reinvestment of all dividends. The dates on the performance graph represents the last trading day of each year indicated. The amounts noted on the performance graph have been adjusted to give effect to all stock splits and stock dividends.

	Period Ending					
Index	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**
First Financial Bankshares, Inc.	100.00	107.66	132.60	123.16	185.87	187.72
Russell 3000	100.00	106.12	122.80	129.11	80.94	103.88
SNL Bank $1B-$5B	100.00	98.29	113.74	82.85	68.72	49.26

Source: SNL Financial LC, Charlottesville, VA

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ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below as of and for the years ended December 31, 2009, 2008, 2007, 2006, and 2005, have been derived from our audited consolidated financial statements. The selected financial data should be read in conjunction with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and accompanying notes presented elsewhere in this Form 10-K. The results of operations presented below are not necessarily indicative of the results of operations that may be achieved in the future. Management s Discussion and Analysis of Financial Condition and Results of Operations incorporates information required to be disclosed by the Securities and Exchange Commission s Industry Guide 3, Statistical Disclosure by Bank Holding Companies.

	Year Ended December 31,				
	2009	**2008**	**2007**	**2006**	**2005**
	(dollars in thousands, except per share data)				
Summary Income Statement Information:					
Interest income	$ 146,445	$ 159,154	$ 169,369	$ 154,494	$ 123,944
Interest expense	17,274	35,259	58,557	48,628	28,757
Net interest income	129,171	123,895	110,812	105,866	95,187
Provision for loan losses	11,419	7,957	2,331	2,061	1,320
Noninterest income	48,598	49,453	48,273	44,668	44,180
Noninterest expense	94,000	91,587	86,827	83,017	75,487
Earnings before income taxes	72,350	73,804	69,927	65,456	62,560
Income tax expense	18,553	20,640	20,437	19,427	18,537
Net earnings	$ 53,797	$ 53,164	$ 49,490	$ 46,029	$ 44,023
Per Share Data:					
Net earnings per share, basic	$ 2.58	$ 2.56	$ 2.38	$ 2.22	$ 2.13
Net earnings per share, assuming dilution	2.58	2.55	2.38	2.21	2.12
Cash dividends declared	1.36	1.34	1.26	1.18	1.10
Book value at period-end	19.96	17.73	16.16	14.51	13.34
Earnings performance ratios:					
Return on average assets	1.72%	1.74%	1.72%	1.68%	1.80%
Return on average equity	13.63	15.27	15.87	16.20	16.17
Summary Balance Sheet Data (Period-end):					
Securities	$ 1,285,377	$ 1,318,406	$ 1,128,493	$ 1,129,313	$ 1,046,121
Loans	1,514,369	1,566,143	1,528,020	1,373,735	1,288,604
Total assets	3,279,456	3,212,385	3,070,309	2,850,165	2,733,827
Deposits	2,684,757	2,582,753	2,546,083	2,384,024	2,366,277
Total liabilities	2,863,754	2,843,603	2,734,814	2,549,263	2,457,551
Total shareholders equity	415,702	368,782	335,495	300,901	276,276
Asset quality ratios:					
Allowance for loan losses/period-end loans	1.82%	1.37%	1.14%	1.18%	1.14%
	1.46	0.80	0.31	0.30	0.33

Nonperforming assets/period-end loans plus foreclosed assets					
Net charge offs/average loans	0.36	0.25	0.07	0.04	0.10
Capital ratios:					
Average shareholders equity/average assets	12.63%	11.37%	10.84%	10.38%	11.11%
Leverage ratio (1)	10.69	9.68	9.23	8.87	8.56
Tier 1 risk-based capital (2)	17.73	15.89	14.65	14.35	14.17
Total risk-based capital (3)	18.99	17.04	15.62	15.32	15.13
Dividend payout ratio	52.63	52.41	52.86	53.14	51.55

(1) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss) less intangible assets by fourth quarter average assets less intangible assets.

(2) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss) less intangible assets by risk-adjusted assets.

(3) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss)

less intangible assets plus allowance for loan losses to the extent allowed under regulatory guidelines by risk-adjusted assets.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

As a multi-bank financial holding company, we generate most of our revenue from interest on loans and investments, trust fees, and service charges. Our primary source of funding for our loans and investments are deposits held by our subsidiary banks. Our largest expenses are interest on these deposits and salaries and related employee benefits. We usually measure our performance by calculating our return on average assets, return on average equity, our regulatory leverage and risk based capital ratios, and our efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax equivalent basis and noninterest income.

You should read the following discussion and analysis of the major elements of our consolidated balance sheets as of December 31, 2009 and 2008, and consolidated statements of earnings for the years 2007 through 2009 in conjunction with our consolidated financial statements, accompanying notes, and selected financial data presented elsewhere in this Form 10-K.

Critical Accounting Policies

We prepare consolidated financial statements based on the selection of certain accounting policies, generally accepted accounting principles and customary practices in the banking industry. These policies, in certain areas, require us to make significant estimates and assumptions.

We deem a policy critical if (1) the accounting estimate required us to make assumptions about matters that are highly uncertain at the time we make the accounting estimate; and (2) different estimates that reasonably could have been used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the financial statements.

The following discussion addresses (1) our allowance for loan losses and its provision for loan losses and (2) our valuation of securities, which we deem to be our most critical accounting policies. We have other significant accounting policies and continue to evaluate the materiality of their impact on our consolidated financial statements, but we believe these other policies either do not generally require us to make estimates and judgments that are difficult or subjective, or it is less likely they would have a material impact on our reported results for a given period.

Allowance for Loan Losses:

The allowance for loan losses is an amount we believe will be adequate to absorb inherent estimated losses on existing loans in which full collectibility is unlikely based upon our review and evaluation of the loan portfolio. The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries).

Our methodology is based on current authoritative accounting guidance, including guidance from the SEC. We also follow the guidance of the Interagency Policy Statement on the Allowance for Loan and Lease Losses, issued jointly by the OCC, the Federal Reserve Board, the FDIC, the National Credit Union Administration and the Office of Thrift Supervision. We have developed a loan review methodology that includes allowances assigned to certain classified loans, allowances assigned based upon estimated loss factors and qualitative reserves. The level of the allowance reflects our periodic evaluation of general economic conditions, the financial condition of our borrowers, the value and liquidity of collateral, delinquencies, prior loan loss experience, and the results of periodic reviews of the portfolio by our independent loan review department and regulatory examiners.

Our allowance for loan losses is comprised of three elements: (i) specific reserves determined in accordance with current authoritative accounting guidance based on probable losses on specific classified loans; (ii) general reserves determined in accordance with current authoritative accounting guidance that consider historical loss rates; and (iii) a qualitative reserve determined in accordance with current authoritative accounting guidance based upon general economic conditions and other qualitative risk factors both internal and external to the Company. We regularly evaluate our allowance for loan losses to maintain an adequate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of specific reserves include the credit-worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All classified loans are specifically reviewed and a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the loan portfolio less cash secured loans, government guaranteed loans and classified loans is multiplied by the Company s recent historical loss rates. The qualitative reserves are determined by evaluating such things as current economic conditions and trends, including unemployment, changes in lending staff, policies or procedures, changes in credit concentrations, changes in the trends and severity of problem loans and changes in trends in volume and terms of loans.

Although we believe we use the best information available to make loan loss allowance determinations, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making our initial determinations. A further downturn in the economy and employment could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in income. Additionally, as an integral part of their examination process, bank regulatory agencies periodically review the adequacy of our allowance for loan losses. The bank regulatory agencies could require additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, the borrower s financial condition is such that collection of principal and interest is doubtful.

Our policy requires measurement of the allowance for an impaired collateral dependent loan based on the fair value of the collateral. Other loan impairments are measured based on the present value of expected future cash flows or the loan s observable market price.

Valuation of Securities:

The Company s available-for-sale and trading securities portfolio is recorded at fair value.

Fair values of these securities are determined based on methodologies in accordance with current authoritative accounting guidance. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, credit ratings and yield curves. Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security.

When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exists. Available-for-sale and held-to-maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (i) whether we have the intent to sell our securities prior to recovery and/or maturity and (ii) whether it is more likely than not that we will not have to sell our securities prior to recovery and/or maturity. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company s results of operations and financial condition.

Results of Operations

Performance Summary. Net earnings for 2009 were $53.8 million, an increase of $633,000, or 1.19%, over net earnings for 2008 of $53.2 million. Net earnings for 2007 were $49.5 million. The increase in net earnings for 2009 over 2008 was primarily attributable to growth in net interest income. The increase in net earnings for 2008 over 2007 was primarily attributable to growth in net interest income and noninterest income.

On a basic net earnings per share basis, net earnings were $2.58 for 2009 as compared to $2.56 for 2008 and $2.38 for 2007. The return on average assets was 1.72% for 2009 as compared to 1.74% for 2008 and 1.72% for 2007. The return on average equity was 13.63% for 2009 as compared to 15.27% for 2008 and 15.87% for 2007.

Net Interest Income. Net interest income is the difference between interest income on earning assets and interest expense on liabilities incurred to fund those assets. Our earning assets consist primarily of loans and investment securities. Our liabilities to fund those assets consist primarily of noninterest-bearing and interest-bearing deposits. Tax-equivalent net interest income was $139.0 million in 2009 as compared to $131.0 million in 2008 and $116.1 million in 2007. The increase in 2009 compared to 2008 was largely attributable to the decrease in the rate paid on interest-bearing liabilities in an amount greater than the decrease in rates earned on interest earning assets and an increase in the volume of earning assets. Average earning assets increased $91.9 million in 2009. The increase in taxable and tax-exempt investment securities of $122.8 million offset the decrease in loans of $42.2 million. The yield on earning assets decreased 53 basis points in 2009, whereas the rate paid on interest-bearing liabilities decreased 91 basis points. The increase in 2008 compared to 2007 resulted primarily from an increase in the volume of earnings assets, which was partially reduced by increases in the rates paid on interest bearing liabilities. Average earning assets were $2.895 billion in 2009, as compared to $2.803 billion in 2008 and $2.624 billion in 2007. The 2009 increase in average earning assets was attributable primarily to purchases of investment securities. The 2008 increase in average earning assets was attributable primarily to internally generated loan growth. Table 1 allocates the change in tax-equivalent net interest income between the amount of change attributable to volume and to rate.

Table 1 Changes in Interest Income and Interest Expense (in thousands):

	2009 Compared to 2008			2008 Compared to 2007		
	Change Attributable to			Change Attributable to		
	Volume	Rate	Total Change	Volume	Rate	Total Change
Short-term investments	$ 768	$ (2,143)	$ (1,375)	$ 207	$ (2,179)	$ (1,972)
Taxable investment securities (1)	1,045	(2,216)	(1,171)	854	(1,448)	(594)
Tax-exempt investment securities (2)	6,155	137	6,292	2,809	570	3,379
Loans (1)	(2,893)	(10,818)	(13,711)	8,765	(17,972)	(9,207)
Interest income	5,075	(15,040)	(9,965)	12,635	(21,029)	(8,394)
Interest-bearing deposits	(371)	(16,266)	(16,637)	1,165	(20,035)	(18,870)
Short-term borrowings	54	(1,403)	(1,349)	695	(5,123)	(4,428)
Interest expense	(317)	(17,669)	(17,986)	1,860	(25,158)	(23,298)
Net interest income	$ 5,392	$ 2,629	$ 8,021	$ 10,775	$ 4,129	$ 14,904

(1) Trading securities are included in

taxable investment securities.

(2) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.

The net interest margin, which measures tax-equivalent net interest income as a percentage of average earning assets, is illustrated in Table 2 for the years 2007 through 2009. The net interest margin in 2009 was 4.80%, an increase of 13 basis points from 2008 and 37 basis points from 2007. Our net interest margin increased from prior periods despite the volatile interest rate environment which saw the Federal funds rate drop 500 basis points since September 2007. We have been somewhat successful in implementing interest rate floors on our loans and have improved the pricing for loan risk, which previously we were unable to do due to competition. Additionally we have purchased investment securities at favorable yields. Should interest rates remain at the current low levels in 2010, we anticipate that the impact of lower yields on loans and investment securities and competition for deposits may put pressure on our net interest margin.

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Table 2 Average Balances and Average Yields and Rates (in thousands, except percentages):

	2009			2008			2007		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets									
Short-term investments	$ 91,755	$ 415	0.45%	$ 80,495	$ 1,790	2.22%	$ 76,284	$ 3,762	4.93%
Taxable investment securities (1)(2)	874,330	37,115	4.24	851,099	38,286	4.50	832,807	38,881	4.67
Tax-exempt investment securities (2)(3)	433,780	26,950	6.21	334,204	20,658	6.18	287,468	17,279	6.01
Loans (3)(4)	1,494,876	91,797	6.14	1,537,027	105,508	6.86	1,427,922	114,714	8.03
Total earning assets	2,894,741	156,277	5.40	2,802,825	166,242	5.93	2,624,481	174,636	6.66
Cash and due from banks	88,651			115,767			107,280		
Bank premises and equipment, net	64,541			64,289			61,036		
Other assets	37,774			35,776			34,075		
Goodwill and other intangible assets, net	63,567			64,598			65,942		
Allowance for loan losses	(23,722)			(19,226)			(16,621)		
Total assets	$ 3,125,552			$ 3,064,029			$ 2,876,193		
Liabilities and Shareholders Equity									
Interest-bearing deposits	$ 1,755,275	$ 16,474	0.94%	$ 1,775,158	$ 33,110	1.87%	$ 1,736,227	$ 51,980	2.99%
Short-term borrowings	183,228	800	0.44	178,721	2,149	1.20	161,648	6,577	4.07
Total interest-bearing liabilities	1,938,503	17,274	0.89	1,953,879	35,259	1.80	1,897,875	58,557	3.09
Noninterest-bearing deposits	758,112			741,418			649,642		
Other liabilities	34,125			20,461			16,878		
Total liabilities	2,730,740			2,715,758			2,564,395		
Shareholders equity	394,812			348,271			311,798		
	$ 3,125,552			$ 3,064,029			$ 2,876,193		

Total liabilities and shareholders equity			
Net interest income	$ 139,003	$ 130,983	$ 116,079
Rate Analysis:			
Interest income/earning assets	5.40%	5.93%	6.66%
Interest expense/earning assets	0.60	1.26	2.23
Net yield on earning assets	4.80%	4.67%	4.43%

(1) Trading securities are included in taxable investment securities.

(2) Average balances include unrealized gains and losses on available-for-sale securities.

(3) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.

(4) Nonaccrual loans are included in loans.

Noninterest Income. Noninterest income for 2009 was $48.6 million, a decrease of $855 thousand, or 1.7%, as compared to 2008. The decrease is primarily attributable to (1) a decrease of $692 thousand in the gain on sale of student loans, (2) a decrease of $641 thousand in service charges on deposit accounts, (3) an increase in the net loss on the sale of foreclosed assets of $553 thousand and (4) a decrease in trust fees of $358 thousand. We recorded a gain of $983 thousand on the sale of approximately $86.0 million in student loans in 2009, compared with a gain of $1.7 million recognized on the sale of $63.0 million in 2008. The Company has suspended its student loan origination activities as a result of changes mandated by the Department of Education that significantly reduced the profitability of the student loan program and we do not currently anticipate significant net revenues from the sale of such loans in 2010. The decline in service charges on deposit accounts was the result of a continuing decrease in usage of overdraft privileges by our customers. The decline in trust fees reflects declines in the market value of the equity investments under management and lower oil and gas prices, offset in part by an increase of $33.6 million in assets under management over the prior year. The fair value of our trust assets, which are not reflected in our consolidated balance sheet, totaled $2.102 billion at December 31, 2009 compared to $1.882 billion at December 31, 2008. These decreases in noninterest income were partially offset by (1) an increase in the net gain on the sale of investment securities of $799 thousand, (2) and an increase in ATM and credit card fees of $642 thousand primarily as a result of increased use of debit cards and (3) an increase in real estate mortgage fees of $373 thousand.

Noninterest income for 2008 was $49.5 million, an increase of $1.2 million, or 2.4%, as compared to 2007. The increase is primarily attributable to (1) an increase of $1.4 million in ATM and credit card fees primarily as a result of increased use of debit cards, (2) an increase of $902 thousand in the net gain on securities transactions, and (3) an increase of $694 thousand in trust fees. The fair value of our trust assets totaled $1.882 billion at December 31, 2008 compared to $1.803 billion at December 31, 2007. These increases were partially offset by (1) a decrease of $811 thousand in real estate mortgage fees, (2) a decrease of $323 thousand in service charges on deposit accounts and (3)

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a decrease of $238 thousand in the gain on sale of student loans. The decrease in real estate mortgage fees reflected the slowdown in residential lending activity. The decline in service charges on deposit accounts was the result of a decrease in customer use of our overdraft privilege product. In 2008, we sold student loans totaling $63.0 million compared to $64.0 million in 2007.

Table 3 Noninterest Income (in thousands):

	2009	Increase (Decrease)	2008	Increase (Decrease)	2007
Trust fees	$ 9,083	$ (358)	$ 9,441	$ 694	$ 8,747
Service charges on deposit accounts	21,956	(641)	22,597	(323)	22,920
Real estate mortgage fees	2,909	373	2,536	(811)	3,347
Gain on sale of student loans	983	(692)	1,675	(238)	1,913
ATM and credit card fees	9,546	642	8,904	1,383	7,521
Net gain on securities transactions	1,851	799	1,052	902	150
Other:					
Net gain (loss) on sale of other real estate	(548)	(553)	5	(103)	108
Check printing fees	434	(55)	489	(106)	595
Safe deposit rental fees	446		446	(3)	449
Exchange fees	91	(44)	135	(30)	165
Credit life and debt protection fees	202	(1)	203	(60)	263
Brokerage commissions	296	(53)	349	157	192
Interest on loan recoveries	293	(54)	347	63	284
Miscellaneous income	1,056	(218)	1,274	(345)	1,619
Total other	2,270	(978)	3,248	(427)	3,675
Total Noninterest Income	$ 48,598	$ (855)	$ 49,453	$ 1,180	$ 48,273

Noninterest Expense. Total noninterest expense for 2009 was $94.0 million, an increase of $2.4 million, or 2.6%, as compared to 2008. Noninterest expense for 2008 amounted to $91.6 million, an increase of $4.8 million, or 5.5%, as compared to 2007. An important measure in determining whether a banking company effectively manages noninterest expenses is the efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax-equivalent basis and noninterest income. Lower ratios indicate better efficiency since more income is generated with a lower noninterest expense total. Our efficiency ratio for 2009 was 50.11% compared to 50.76% for 2008, and 52.83% for 2007.

Salaries and employee benefits for 2009 totaled $49.5 million, an increase of $201 thousand, or 0.4%, as compared to 2008. The primary causes of this increase were an increase in pension expense as a result of changes in actuarial assumptions, overall pay increases effective during the first quarter of 2009 and an increase in employee medical expenses offset by a reduction in the number of employees and profit sharing expense.

All other categories of non interest expense for 2009 totaled $44.5 million, an increase of $2.2 million, or 5.2%, as compared to 2008. The increase in noninterest expense was largely the result of an increase of $4.2 million in FDIC insurance premiums, resulting from (i) the special assessment of $1.4 million, (ii) having utilized FDIC premium insurance credits in prior periods and (iii) an increase in 2009 of FDIC insurance premium rates. The FDIC required member banks to prepay on December 30, 2009 their 2010 to 2012 FDIC insurance premiums, including a three basis point increase in premium rates for 2011 and 2012. The 2010 to 2012 prepayment will be expensed with quarterly assessment notices. The increase in professional and service fees of $258 thousand reflected higher costs associated with servicing the Company s student loans and expenses related to an upgraded funds transfer system. ATM and debit card interchange expenses decreased $1.1 million primarily as a result of better pricing with our processor. Net occupancy expense decreased $442 thousand as a result of lower utilities expense.

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Salaries and employee benefits for 2008 totaled $49.3 million, an increase of $2.3 million, or 5.0%, as compared to 2007. The primary causes of this increase were higher levels of contributions to the Company s profit sharing plan, overall pay increases effective during the first quarter of 2008 and an increase in employee medical expenses.

All other categories of non interest expense for 2008 totaled $42.3 million, an increase of $2.4 million, or 6.1%, as compared to 2007. Net occupancy expense increased $842 thousand primarily as a result of higher utilities expense and three new branches. ATM and debit card interchange expenses increased $586 thousand reflecting increased debit card use by our customers, as seen in the increase in the related income above. Equipment expense increased $327 thousand reflecting ongoing investments in technology. Professional and service fees increased $305 thousand as a result of an increase in actuarial fees related to the Company s pension plan and higher expenses related to the treasury management services offered to Company s customers.

Table 4 Noninterest Expense (in thousands):

	2009	Increase (Decrease)	2008	Increase (Decrease)	2007
Salaries	$ 38,661	$ 398	$ 38,263	$ 1,619	$ 36,644
Medical	3,427	92	3,335	605	2,730
Profit sharing	2,360	(1,046)	3,406	186	3,220
Pension	738	604	134	(176)	310
401(k) match expense	1,178	45	1,133	6	1,127
Payroll taxes	2,808	20	2,788	95	2,693
Stock option expense	314	88	226	6	220
Total salaries and employee benefits	49,486	201	49,285	2,341	46,944
Net occupancy expense	6,293	(442)	6,735	842	5,893
Equipment expense	7,743	196	7,547	327	7,220
Printing, stationery and supplies	1,892	1	1,891	(113)	2,004
Correspondent bank service charges	1,032	(137)	1,169	16	1,153
FDIC insurance premiums	4,893	4,241	652	374	278
ATM expense	2,782	(1,139)	3,921	586	3,335
Professional and service fees	2,543	258	2,285	305	1,980
Intangible amortization	851	(353)	1,204	(290)	1,494
Other:					
Data processing fees	420	5	415	24	391
Postage	1,489	52	1,437	22	1,415
Advertising	1,239	38	1,201	22	1,179
Credit card fees	418	(104)	522	(14)	536
Telephone	1,356	90	1,266	9	1,257
Public relations and business development	1,326	(64)	1,390	81	1,309
Directors fees	702	(3)	705	55	650
Audit and accounting fees	1,220	(148)	1,368	193	1,175
Legal fees	552	34	518	(41)	559
Regulatory exam fees	848	37	811	26	785
Travel	526	(103)	629	41	588
Courier expense	558	(217)	775	15	760
Operational and other losses	976	(341)	1,317	(545)	1,862
Other real estate	588	299	289	190	99

Other miscellaneous expense	4,267	12	4,255	294	3,961
Total other	16,485	(413)	16,898	372	16,526
Total Noninterest Expense	$ 94,000	$ 2,413	$ 91,587	$ 4,760	$ 86,827

Income Taxes. Income tax expense was $18.6 million for 2009 as compared to $20.6 million for 2008 and $20.4 million for 2007. Our effective tax rates on pretax income were 25.6%, 28.0% and 29.2%, respectively, for the years 2009, 2008 and 2007. The effective tax rates differ from the statutory federal tax rate of 35% largely due to tax exempt interest income earned on certain investment securities and loans, the deductibility of dividends paid to our employee stock ownership plan and Texas state taxes. The decrease in the effective tax rate during 2009 was primarily the result of an increase in holdings of tax-exempt municipal securities.

Balance Sheet Review

Loans. Our portfolio is comprised of loans made to businesses, professionals, individuals, and farm and ranch operations located in the primary trade areas served by our subsidiary banks. Real estate loans represent loans primarily for new home construction and owner-occupied real estate. The structure of loans in the real estate mortgage classification generally provides repricing intervals to minimize the interest rate risk inherent in long-term fixed rate loans. As of December 31, 2009, total loans were $1.514 billion, a decrease of $51.8 million, as compared to December 31, 2008. As compared to year-end 2008, real estate loans decreased $6.3 million, commercial, financial and agricultural loans increased $22.7 million, and consumer loans decreased $68.2 million, primarily as a result of suspending student loan origination activities. As of December 31, 2009, the Company did not hold any student loans held for sale. As of December 31, 2008, student loans held for sale of $51.8 million were included in consumer loans. Loans averaged $1.495 billion during 2009, a decrease of $42.2 million over the prior year average balances.

Table 5 Composition of Loans (in thousands):

	December 31,				
	2009	**2008**	**2007**	**2006**	**2005**
Commercial, financial and agricultural	$ 508,431	$ 485,707	$ 493,478	$ 430,286	$ 410,191
Real estate construction	77,711	158,000	196,250	155,285	112,892
Real estate mortgage	752,735	678,788	626,146	591,893	568,793
Consumer, net of unearned income	175,492	243,648	212,146	196,271	196,728
	$ 1,514,369	$ 1,566,143	$ 1,528,020	$ 1,373,735	$ 1,288,604

Our real estate loans represent approximately 55% of our loan portfolio and are comprised of (i) commercial real estate loans (33%), generally owner occupied, (ii) 1-4 family residence loans (33%), (iii) residential development and construction loans (9%), which includes our custom and speculation home construction loans, (iv) commercial development and construction loans (5%) and (v) other (20%).

Table 6 Maturity Distribution and Interest Sensitivity of Loans at December 31, 2009 (in thousands):

The following tables summarize maturity and repricing information for the commercial, financial, and agricultural and the real estate-construction portion of our loan portfolio as of December 31, 2009:

	One Year or less	After One Year Through Five Years	After Five Years	Total
Commercial, financial, and agricultural	$ 257,582	$ 155,904	$ 94,945	$ 508,431
Real estate construction	54,445	17,377	5,889	77,711
	$ 312,027	$ 173,281	$ 100,834	$ 586,142

	Maturities After One Year
Loans with fixed interest rates	$ 187,060
Loans with floating or adjustable interest rates	87,055

$	274,115

Asset Quality. Loan portfolios of each of our subsidiary banks are subject to periodic reviews by our centralized independent loan review group as well as periodic examinations by state and federal bank regulatory agencies. Loans are placed on nonaccrual status when, in the judgment of management, the collectibility of principal or interest under the original terms becomes doubtful. Nonaccrual, past due 90 days still accruing and restructured loans plus foreclosed assets, were $22.1 million at December 31, 2009, as compared to $12.5 million at

December 31, 2008 and $4.7 million at December 31, 2007. As a percent of loans and foreclosed assets, these assets were 1.46% at December 31, 2009, as compared to 0.80% at December 31, 2008 and 0.31% at December 31, 2007. As a percent of total assets, these assets were 0.67% at December 31, 2009, as compared to 0.39% at December 31, 2008 and 0.15% at December 31, 2007. The higher level of these assets in 2009 is a result of the national recession and the slower Texas economy. We believe the level of these assets to be manageable and are not aware of any material classified credit not properly disclosed as nonperforming at December 31, 2009.

Table 7 Nonaccrual, Past Due 90 Days Still Accruing and Restructured Loans and Foreclosed Assets (in thousands, except percentages):

	At December 31,				
	2009	**2008**	**2007**	**2006**	**2005**
Nonaccrual loans	$ 18,540	$ 9,893	$ 3,189	$ 3,529	$ 3,524
Loans still accruing and past due 90 days or more	15	36	36	129	15
Restructured loans					
Nonperforming loans	18,555	9,929	3,225	3,658	3,539
Foreclosed assets	3,533	2,602	1,506	453	705
Total nonperforming assets	$ 22,088	$ 12,531	$ 4,731	$ 4,111	$ 4,244
As a % of loans and foreclosed assets	1.46%	0.80%	0.31%	0.30%	0.33%
As a % of total assets	0.67%	0.39%	0.15%	0.14%	0.16%

The majority of our nonaccrual loans are in our bank subsidiaries closer to the Dallas-Fort Worth metroplex where we have seen more credit deterioration in our loan portfolio. The major categories of nonaccrual loans are (i) 1-4 family residences (46.4%), (ii) ranches (18.7%) and (iii) lots for development (15.8%).

We record interest payments received on impaired loans as interest income unless collections of the remaining recorded investment are placed on nonaccrual, at which time we record payments received as reductions of principal. We recognized interest income on impaired loans of approximately $691,000, $409,000 and $100,000 during the years ended December 31, 2009, 2008, and 2007, respectively. If interest on impaired loans had been recognized on a full accrual basis during the years ended December 31, 2009, 2008, and 2007, respectively, such income would have approximated $1,417,000, $624,000 and $358,000.

Provision and Allowance for Loan Losses. The allowance for loan losses is the amount we determine as of a specific date to be adequate to provide for losses on loans that we deem are uncollectible. We determine the allowance and the required provision expense by reviewing general loss experience and the performance of specific credits. The provision for loan losses was $11.4 million for 2009 as compared to $8.0 million for 2008 and $2.3 million for 2007. The increase in the provision in 2009 was due to concern for a slowing Texas real estate market, the national recession and a higher level of nonaccrual loans and foreclosed assets. The increase in 2008 compared with 2007 was due to growth in the loan portfolio and a slowing Texas real estate market. As a percent of average loans, net loan charge-offs were 0.36% during 2009, 0.25% during 2008 and 0.07% during 2007. The allowance for loan losses as a percent of loans was 1.82% as of December 31, 2009, as compared to 1.37% as of December 31, 2008. Included in Tables 8 and 9 are further analysis of our allowance for loan losses compared to nonperforming assets and charge-offs.

Although we believe we use the best information available to make loan loss allowance determinations, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making our initial determinations. The current downturn in the economy or lower employment could result in increased levels of nonaccrual, past due 90 days still accruing and restructured loans and foreclosed assets, charge-offs, increased loan loss provisions and reductions in income. Additionally, as an integral part of their examination process, bank regulatory agencies periodically review the adequacy of our allowance for loan losses. The banking agencies could require additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

Table 8 Loan Loss Experience and Allowance for Loan Losses (in thousands, except percentages):

	2009	2008	2007	2006	2005
Balance at January 1,	$ 21,529	$ 17,462	$ 16,201	$ 14,719	$ 13,837
Allowance established from purchase acquisitions					793
	21,529	17,462	16,201	14,719	14,630
Charge-offs:					
Commercial, financial and agricultural	1,188	1,937	1,056	956	783
Real estate	3,072	1,696			84
Consumer	1,950	1,082	742	865	1,088
All other					2
Total charge-offs	6,210	4,715	1,798	1,821	1,957
Recoveries:					
Commercial, financial and agricultural	190	342	341	739	174
Real estate	122	133	5	8	39
Consumer	562	350	376	487	507
All other			6	8	6
Total recoveries	874	825	728	1,242	726
Net charge-offs	5,336	3,890	1,070	579	1,231
Provision for loan losses	11,419	7,957	2,331	2,061	1,320
Balance at December 31,	$ 27,612	$ 21,529	$ 17,462	$ 16,201	$ 14,719
Loans at year-end	$ 1,514,369	$ 1,566,143	$ 1,528,020	$ 1,373,735	$ 1,288,604
Average loans	1,494,876	1,537,027	1,427,922	1,308,309	1,209,095
Net charge-offs/average loans	0.36%	0.25%	0.07%	0.04%	0.10%
Allowance for loan losses/year-end loans	1.82	1.37	1.14	1.18	1.14
Allowance for loan losses/nonaccrual, past due 90 days still accruing and restructured loans	148.81	216.83	541.49	442.94	415.91

The ratio of our allowance to nonaccrual, past due 90 days still accruing and restructured loans has trended downward since 2007, as the economic conditions began to worsen. Although the ratio declined substantially in 2009 and 2008 from prior years when net charge-offs and nonperforming asset levels were historically low, management believes the allowance for loan losses is adequate at December 31, 2009 inspite of these trends.

Table 9 Allocation of Allowance for Loan Losses (in thousands):

	2009 Allocation Amount	2008 Allocation Amount	2007 Allocation Amount	2006 Allocation Amount	2005 Allocation Amount
Commercial, financial and agricultural	$ 10,329	$ 8,687	$ 7,786	$ 7,808	$ 5,962
Real estate construction	4,550	4,938	1,887	1,357	855
Real estate mortgage	11,828	6,634	6,117	5,483	6,572
Consumer	905	1,270	1,672	1,553	1,330
Total	$ 27,612	$ 21,529	$ 17,462	$ 16,201	$ 14,719

Percent of Total Loans:

	2009	2008	2007	2006	2005
Commercial, financial and agricultural	33.57%	31.01%	32.30%	31.32%	31.83%
Real est					