

PROSPERITY BANCSHARES INC
Form 10-Q
August 10, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 000-25051

PROSPERITY BANCSHARES, INC.[®]

(Exact name of registrant as specified in its charter)

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TEXAS
(State or other jurisdiction of
incorporation or organization)

74-2331986
(I.R.S. Employer

Identification No.)

Prosperity Bank Plaza

4295 San Felipe

Houston, Texas 77027

(Address of principal executive offices, including zip code)

(281) 269-7199

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if a smaller reporting company)

Smaller Reporting Company

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

As of August 1, 2009, there were 46,131,071 outstanding shares of the registrant's Common Stock, par value \$1.00 per share.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

PROSPERITY BANCSHARES, INC[®]. AND SUBSIDIARIES**CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

	June 30 2009	December 31, 2008
(Dollars in thousands, except share data)		
ASSETS		
Cash and due from banks	\$ 142,860	\$ 212,335
Federal funds sold	128,451	16,298
Total cash and cash equivalents	271,311	228,633
Interest-bearing deposits in financial institutions		106
Available for sale securities, at fair value (amortized cost of \$638,818 and \$802,086, respectively)	658,971	817,244
Held to maturity securities, at cost (fair value of \$3,402,235 and \$3,408,981, respectively)	3,322,138	3,343,157
Loans held for investment	3,451,220	3,566,958
Loans held for sale	99	99
Less allowance for credit losses	(42,611)	(36,970)
Loans, net	3,408,708	3,530,087
Accrued interest receivable	31,220	34,617
Goodwill	875,082	874,654
Core deposit intangibles, net of accumulated amortization of \$36,442 and \$31,287, respectively	40,305	38,196
Bank premises and equipment, net	149,742	123,638
Other real estate owned	11,101	4,450
Bank Owned Life Insurance (BOLI)	47,438	46,794
Federal Home Loan Bank of Dallas stock	7,930	15,483
Leased assets	646	928
Other assets	14,007	14,377
TOTAL ASSETS	\$ 8,838,599	\$ 9,072,364
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 1,476,378	\$ 1,522,983
Interest-bearing	5,781,517	5,780,314
Total deposits	7,257,895	7,303,297
Other borrowings	28,170	229,395
Securities sold under repurchase agreements	96,732	96,017
Accrued interest payable	10,694	14,625
Other liabilities	54,100	81,659
Junior subordinated debentures	92,265	92,265
Total liabilities	7,539,856	7,817,258

COMMITMENTS AND CONTINGENCIES

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SHAREHOLDERS EQUITY:

Preferred stock, \$1 par value; 20,000,000 shares authorized; none issued or outstanding		
Common stock, \$1 par value; 200,000,000 shares authorized; 46,146,198 and 46,116,801 shares issued at June 30, 2009 and December 31, 2008, respectively; 46,109,110 and 46,079,713 shares outstanding at June 30, 2009 and December 31, 2008, respectively	46,146	46,117
Capital surplus	868,431	867,380
Retained earnings	371,674	332,363
Accumulated other comprehensive income unrealized gain on available for sale securities, net of tax of \$7,054 and \$5,305, respectively	13,099	9,853
Treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders equity	1,298,743	1,255,106
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 8,838,599	\$ 9,072,364

See notes to interim condensed consolidated financial statements.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands, except per share data)			
INTEREST INCOME:				
Loans, including fees	\$ 55,248	\$ 55,948	\$ 111,050	\$ 114,468
Securities	47,450	25,856	97,178	50,639
Federal funds sold and other earning assets	70	175	106	1,337
Total interest income	102,768	81,979	208,334	166,444
INTEREST EXPENSE:				
Deposits	25,621	25,210	55,078	54,155
Junior subordinated debentures	959	1,558	2,078	3,577
Securities sold under repurchase agreements	280	574	628	1,178
Note payable and federal funds sold	387	666	951	1,568
Total interest expense	27,247	28,008	58,735	60,478
NET INTEREST INCOME	75,521	53,971	149,599	105,966
PROVISION FOR CREDIT LOSSES	6,900	1,000	13,025	2,167
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	68,621	52,971	136,574	103,799
NONINTEREST INCOME:				
Customer service fees	12,863	10,727	25,235	21,233
Other	2,270	2,339	4,915	4,512
Total noninterest income	15,133	13,066	30,150	25,745
NONINTEREST EXPENSE:				
Salaries and employee benefits	20,494	16,751	43,142	32,881
Net occupancy expense	3,514	2,867	7,492	5,677
Depreciation expense	2,069	1,920	4,070	3,857
Data processing	1,562	1,361	3,617	2,652
Core deposit intangible amortization	2,492	2,459	5,156	4,951
Other	14,169	5,502	24,846	9,962
Total noninterest expense	44,300	30,860	88,323	59,980
INCOME BEFORE INCOME TAXES	39,454	35,177	78,401	69,564
PROVISION FOR INCOME TAXES	12,944	11,740	26,413	23,189

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NET INCOME	\$ 26,510	\$ 23,437	\$ 51,988	\$ 46,375
EARNINGS PER SHARE				
Basic	\$ 0.57	\$ 0.52	\$ 1.13	\$ 1.04
Diluted	\$ 0.57	\$ 0.52	\$ 1.13	\$ 1.04

See notes to interim condensed consolidated financial statements.

Table of Contents**PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY****(UNAUDITED)**

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders Equity
	(Amounts in thousands, except share and per share data)						
BALANCE AT JANUARY 1, 2008	44,188,323	\$ 44,188	\$ 809,026	\$ 273,407	\$ 1,417	\$ (607)	\$ 1,127,431
Comprehensive Income:							
Cumulative effect-split dollar							
Insurance adjustment				(2,174)			(2,174)
Net income				84,507			84,507
Net change in unrealized gain on available for sale securities (net of tax of \$4,542)					8,436		8,436
Total comprehensive income							92,943
Common stock issued in connection with the exercise of stock options and restricted stock awards	170,726	171	2,427				2,598
Common stock issued in connection with the 1 st Choice acquisition	1,757,752	1,758	54,385				56,143
Stock based compensation expense			1,542				1,542
Cash dividends declared, \$0.513 per share				(23,377)			(23,377)
BALANCE AT DECEMBER 31, 2008	46,116,801	46,117	867,380	332,363	9,853	(607)	1,255,106
Comprehensive income:							
Net income				51,988			51,988
Net change in unrealized gain on available for sale securities (net of tax of \$1,749)					3,246		3,246
Total comprehensive income							55,234
Common stock issued in connection with the exercise of stock options and restricted stock awards	29,397	29	431				460
Stock based compensation expense			620				620
Cash dividends declared, \$0.275 per share				(12,677)			(12,677)
BALANCE AT JUNE 30, 2009	46,146,198	\$ 46,146	\$ 868,431	\$ 371,674	\$ 13,099	\$ (607)	\$ 1,298,743

See notes to interim condensed consolidated financial statements.

Table of Contents**PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	Six Months Ended June 30,	
	2009	2008
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 51,988	\$ 46,375
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,226	8,808
Stock based compensation expense	620	641
Net amortization of premium on loans and deposits	(4,003)	(1,009)
Provision for credit losses	13,025	2,167
Net amortization of discount on investments	(1,795)	(1,799)
Net (gain) loss on sale of other real estate	(437)	439
Net gain on sale of premises and equipment	(297)	(680)
Net gain on loans held for sale		(183)
Proceeds from the sale of loans held for sale		8,911
Origination of loans held for sale		
Net decrease in accrued interest receivable and other assets	10,700	2,615
Net decrease in accrued interest payable and other liabilities	(30,423)	(4,681)
Net cash provided by operating activities	48,604	61,604
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of securities held to maturity	425,083	333,427
Purchase of securities held to maturity	(403,001)	(703,164)
Proceeds from maturities, sales and principal paydowns of securities available for sale	713,996	148,726
Purchase of securities available for sale	(549,999)	(124,987)
Net decrease in interest-bearing deposits in financial institutions	106	
Net decrease (increase) in loans held for investment	91,152	(323)
Purchase of bank premises and equipment	(31,110)	(5,319)
Net proceeds from sale of bank premises, equipment and other real estate	12,859	10,913
Purchase of 1 st Choice Bancorp	(17)	(19,129)
Cash and cash equivalents acquired from 1 st Choice Bancorp		84,240
Purchase of Banco Popular branches	(50)	(443)
Cash and cash equivalents acquired in the purchase of Banco Popular branches		112,788
Purchase of Texas United Bancshares, Inc.		(74)
Acquisition of Franklin Bank branches	(405)	
Net cash provided by (used in) investing activities	258,614	(163,345)

Continued

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30,	
	2009	2008
	(In thousands)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in noninterest-bearing deposits	(49,421)	22,101
Net decrease in interest-bearing deposits	(2,392)	(102,454)
Net repayments of long-term debt	(1,225)	(1,377)
Net (repayments of) proceeds from short-term debt	(200,000)	12,000
Redemption of junior subordinated debentures		(20,620)
Net increase in securities sold under repurchase agreements	715	14,644
Proceeds from exercise of stock options	460	2,300
Payments of cash dividends	(12,677)	(11,282)
 Net cash used in financing activities	 (264,540)	 (84,688)
 NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	 \$ 42,678	 \$ (186,429)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	228,633	371,090
 CASH AND CASH EQUIVALENTS, END OF PERIOD	 \$ 271,311	 \$ 184,661
 NON-CASH ACTIVITIES:		
Issuance of common stock for the acquisition of 1 st Choice Bancorp	\$	\$ 56,142
 SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest	\$ 62,666	\$ 61,547
Cash paid for income taxes	28,500	23,300

See notes to interim condensed consolidated financial statements.

Table of Contents**PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2009****(UNAUDITED)****1. BASIS OF PRESENTATION**

The interim condensed consolidated financial statements include the accounts of Prosperity Bancshares, Inc.® (the Company) and its wholly-owned subsidiaries, Prosperity Bank® (the Bank) and Prosperity Holdings of Delaware, LLC. All significant inter-company transactions and balances have been eliminated.

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the statements reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. These financial statements and the notes thereto should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2008. Operating results for the six-month period ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009 or any other period.

2. INCOME PER COMMON SHARE

The following table illustrates the computation of basic and diluted earnings per share:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
	(In thousands, except per share amounts)			
Net income available to common shareholders	\$ 26,510	\$ 23,437	\$ 51,988	\$ 46,375
Weighted average common shares outstanding	46,105	44,852	46,097	44,520
Potential dilutive common shares	120	187	49	156
Weighted average common shares and equivalents outstanding	46,225	45,039	46,146	44,676
Basic earnings per common share	\$ 0.57	\$ 0.52	\$ 1.13	\$ 1.04
Diluted earnings per common share	\$ 0.57	\$ 0.52	\$ 1.13	\$ 1.04

The incremental shares for the assumed exercise of the outstanding options were determined by application of the treasury stock method. There were no stock options outstanding during the quarter ended June 30, 2009 or 2008 that would have had an anti-dilutive effect on the above computation.

3. NEW ACCOUNTING STANDARDS

Statements of Financial Accounting Standards

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim or annual financial period ending after June 15, 2009. The Company adopted SFAS No.165 as of June 30, 2009 and has included the appropriate disclosures.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets*, which is a revision to SFAS No. 140. It requires more information about transfers of financial assets, including securitization transactions and a company's continuing exposure to the risks related to the transfer of financial assets. It eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. SFAS No. 166 is effective for first annual reporting period beginning after November 15, 2009. The Company is evaluating SFAS No. 166 but does not expect that it will have a significant impact on its consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2009

(UNAUDITED)

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which is a revision to FIN No. 46(R), *Consolidation of Variable Interest Entities*. It improves financial reporting by enterprises involved with variable interest entities and changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. SFAS No. 167 is effective for first annual reporting period beginning after November 15, 2009. The Company is evaluating SFAS No. 167 but does not expect that it will have a significant impact on its consolidated financial statements.

In June 2009, FASB issued SFAS No. 168, *FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162*, which states that the FASB Accounting Standards Codification™ (Codification) will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company is currently evaluating the effects of the adoption of SFAS No. 168 and will revise the references within future financial statements for the Codification.

Statement of Financial Accounting Standards (SFAS) No. 141 (SFAS 141R), *Business Combinations (Revised 2007)*. SFAS 141R replaces SFAS 141, *Business Combinations*, and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, *Accounting for Contingencies*. SFAS 141R was effective for the Company on January 1, 2009. The adoption of SFAS 141R will have a significant impact on the Company's accounting for business combinations closing on or after January 1, 2009.

Financial Accounting Standards Board Staff Positions and Interpretations

In April 2009, the FASB issued three Final Staff Positions (FSPs) to provide additional guidance and disclosures regarding fair value measurements and impairments of securities:

FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidance for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased. The Company's adoption of FSP FAS 157-4 did not have a material impact on the Company's consolidated financial statements.

FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in financial statements. The adoption of FSP FAS 115-2 and FAS 124-2 did not have a material impact on the Company's consolidated financial statements.

Table of Contents**PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES****NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2009****(UNAUDITED)**

FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, requires disclosure about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The expanded disclosure requirements for FSP FAS 107-1 are effective for the Company's quarterly financial statements for the three months ended June 30, 2009 and are included in Note 4 – Fair Value Disclosure.

4. FAIR VALUE DISCLOSURES

Effective January 1, 2008, the Company adopted SFAS 157, *Fair Value Measurements*, which defines fair value, addresses aspects of the expanding application of fair value accounting and establishes a consistent framework for measuring fair value. Fair values represent the estimated price that would be received from selling an asset or paid to transfer a liability, otherwise known as an exit price.

Fair Value Hierarchy

SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with SFAS 157, these inputs are summarized in the three broad levels listed below:

Level 1 – Quoted prices in active markets for identical assets or liabilities. Level 1 assets include US Treasury securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities) or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include US government and agency mortgage-backed debt securities, corporate securities, municipal bonds and CRA funds.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to SFAS 157.

The following table presents fair value measurements on a recurring basis as of June 30, 2009:

	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Measured on a recurring basis:				
Available for sale securities (at fair value)	\$	\$ 658,971	\$	\$ 658,971

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TOTAL	\$	\$ 658,971	\$	\$ 658,971
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Certain assets and liabilities are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). These instruments include other real estate owned, repossessed assets and impaired loans per SFAS 114, *Accounting by Creditors for Impairment of a Loan* an amendment of FASB Statements No. 5 and 15. For the three months ended June 30, 2009, the Company had additions to impaired loans of \$645,000 and additions to other real estate owned of \$8.1 million, which were outstanding June 30, 2009. The remaining financial assets and financial liabilities measured at fair value on a non-recurring basis that were recorded in 2009 and remained outstanding at June 30, 2009 were not significant.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2009

(UNAUDITED)

Disclosures of the estimated fair value amounts of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a material effect on the estimated fair value amounts.

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

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

Federal Funds Sold The carrying amount is a reasonable estimate of fair value.

Securities For securities held as investments, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans Held for Investment For certain homogeneous categories of loans (such as some residential mortgages and other consumer loans), fair value is estimated by discounting the future cash flows using the risk-free Treasury rate for the applicable maturity, adjusted for servicing and credit risk. The carrying value of variable rate loans approximates fair value because the loans reprice frequently to current market rates.

Deposits The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Junior Subordinated Debentures The fair value of the junior subordinated debentures was calculated using the quoted market prices, if available. If a quoted market prices are not available, fair value is estimated using quoted market prices for similar subordinated debentures.

Other Borrowings Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt using a discounted cash flows methodology.

Securities Sold Under Repurchase Agreements The fair value of securities sold under repurchase agreements is the amount payable on demand at the reporting date.

Off-Balance Sheet Financial Instruments The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the present creditworthiness of the counterparties.

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In accordance with FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, the carrying amount and estimated fair values of the Company's financial instruments are as follows:

	June 30, 2009	
	Carrying Amount	Estimated Fair Value
	(In thousands)	
Financial assets:		
Cash and due from bank	\$ 142,860	\$ 142,860
Federal funds sold	128,451	128,451
Available for sale securities	658,971	658,971
Held to maturity securities	3,322,138	3,402,235
Loans held for investment and for sale	3,451,319	3,480,541
Less allowance for credit losses	(42,611)	(42,611)
Total	\$ 7,661,128	\$ 7,770,447
Financial liabilities:		
Deposits	\$ 7,257,895	\$ 7,282,216
Other borrowings	28,170	29,535
Securities sold under repurchase agreements	96,732	96,732
Junior subordinated debentures	92,265	97,132
Total	\$ 7,475,062	\$ 7,505,615

The Company's off-balance sheet commitments are funded at current market rates at the date they are drawn upon. It is management's opinion that the fair value of these commitments would approximate their carrying value, if drawn upon.

The fair value estimates presented herein are based on pertinent information available to management as of the dates indicated. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

5. GOODWILL AND CORE DEPOSIT INTANGIBLES

Changes in the carrying amount of the Company's goodwill and core deposit intangibles (CDI) for the six months ended June 30, 2009 were as follows:

Goodwill

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	Core Deposit Intangibles	
	(Dollars in thousands)	
Balance as of December 31, 2008	\$ 874,654	\$ 38,196
Amortization		(5,156)
Acquisition of Banco Popular branches	50	
Acquisition of 1 st Choice Bancorp, Inc.	17	
Acquisition of Franklin Bank	361	7,265
Balance as of June 30, 2009	\$ 875,082	\$ 40,305

Purchase accounting adjustments to prior year acquisitions were made to adjust deferred tax asset and liability balances. Goodwill is recorded on the acquisition date of each entity. The Company may record subsequent adjustments to goodwill for amounts undeterminable at acquisition date, such as deferred taxes and real estate valuations, and therefore the goodwill amounts reflected in the table above may change accordingly. The Company initially records the total premium paid on acquisitions as goodwill. After finalizing the valuation, core deposit intangibles are identified and reclassified from goodwill to core deposit intangibles on the balance sheet. This reclassification has no effect on total assets, liabilities, shareholders' equity, net income or cash flows. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangibles has occurred. If any such impairment is determined, a write down is recorded. As of June 30, 2009, there were no impairments recorded on goodwill or other intangibles.

Table of Contents**PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES****NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2009****(UNAUDITED)**

During the six months ended June 30, 2009, the Company completed the valuation of the assets acquired and liabilities assumed in the Franklin Bank acquisition and allocated \$7.3 million to core deposit intangibles and allocated \$7.2 million to certificates of deposit. Both amounts had previously been reflected in goodwill as of December 31, 2008 pending the completed valuations.

Core deposit intangibles are amortized on an accelerated basis over their estimated lives, which the Company believes is between 8 and 10 years. Gross core deposit intangibles outstanding were \$76.7 million and \$69.5 million at June 30, 2009 and December 31, 2008, respectively. Net core deposit intangibles outstanding were \$40.3 million and \$38.2 million at the same dates, respectively. Amortization expense related to intangible assets totaled \$2.5 million for both the three months ended June 30, 2009 and 2008, respectively, and \$5.2 million and \$5.0 million for the six months ended June 30, 2009 and 2008, respectively. The increase in amortization expense was primarily due to the core deposit intangibles from the acquisition of Franklin Bank. The estimated aggregate future amortization expense for intangible assets remaining as of June 30, 2009 is as follows (dollars in thousands):

Remaining 2009	\$ 4,831
2010	8,752
2011	7,420
2012	6,033
2013	4,189
Thereafter	9,080
Total	\$ 40,305

6. STOCK BASED COMPENSATION

At June 30, 2009, the Company had three stock-based employee compensation plans adopted by the Company and five stock option plans assumed in connection with acquisitions under which no additional options will be granted. Two of the three plans adopted by the Company have expired and therefore no additional awards may be issued under the plans. The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payment (Revised 2004)* (*SFAS 123R*). *SFAS 123R* was effective for companies in 2006, however, the Company had been recognizing compensation expense since January 1, 2003. The Company's results of operations reflect compensation expense for all employee stock-based compensation, including the unvested portion of stock options granted prior to 2003. *SFAS No. 123R* requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option pricing model. The Company recognized \$620,000 and \$641,000 in stock-based compensation expense for the six months ended June 30, 2009 and 2008, respectively, and \$294,000 and \$393,000 in stock-based compensation expense for the three months ended June 30, 2009 and 2008, respectively. There was approximately \$146,000 and \$122,000 of income tax benefit recorded for the stock-based compensation expense for the six months ended June 30, 2009 and 2008, respectively, and \$66,000 and \$87,000 of income tax benefit recorded for the stock-based compensation expense for the three months ended June 30, 2009 and 2008, respectively.

The Company has granted shares of common stock (restricted stock) to certain directors and associates under the Company's 2004 Stock Incentive Plan. The awardee is not entitled to the shares until they vest, which is generally over a 1 to 5 year period, but the awardee is entitled to receive dividends on and vote the shares prior to vesting. The shares granted do not have a cost to the awardee and the only requirement of vesting is continued service to the Company. Compensation cost related to restricted stock is calculated based on the market price of the shares

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at the date of grant. If the awardee leaves the Company before the shares vest, the unvested shares are forfeited. As of June 30, 2009, there were 58,656 shares of restricted stock outstanding with a weighted average grant date fair value of \$32.20.

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Stock options are issued at the current market price on the date of the grant, subject to a pre-determined vesting period with a contractual term of 10 years. Options assumed in connection with acquisitions have contractual terms as established in the original option grant agreements entered into prior to acquisition. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

The fair value of options was estimated using an option-pricing model with the following weighted average assumptions:

	June 30,	
	2009	2008
Expected life (years)	5.10	4.96
Risk free interest rate	4.11%	4.16%
Volatility	21.19%	21.21%
Dividend yield	1.22%	1.21%

A summary of changes in outstanding vested and unvested options during the six months ended June 30, 2009 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Options outstanding, beginning of period	917	\$ 24.58		
Options granted	13	29.08		
Options forfeited	(9)	23.52		
Options exercised	(27)	16.85		
Options outstanding, end of period	894	\$ 24.88	4.97	\$ 4,423
Options vested or expected to vest	867	\$ 24.58	4.88	\$ 4,554
Options exercisable, end of period	375	\$ 20.19	3.88	\$ 3,614

A total of 12,500 options at a weighted average exercise price of \$29.08 were granted during the six months ended June 30, 2009 and no options were granted during the six months ended June 30, 2008. The total intrinsic value of the options exercised during the six month periods ended June 30, 2009 and 2008 was \$355,000 and \$1.4 million, respectively. The total fair value of shares vested during the six month periods ended June 30, 2009 and 2008 was \$113,000 and \$180,000, respectively.

A summary of changes in non-vested options is set forth below:

	Number of Options	Six Months Ended June 30,		
		2009	2008	
		Weighted Average Grant Date Fair Value	Number of Options	Weighted Average Grant Date Fair Value

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	(In thousands)		(In thousands)	
Non-vested options outstanding, beginning of period	529	\$ 6.83	707	\$ 6.52
Options granted	13	4.58		
Non-vested options forfeited	(2)	4.34		
Options vested	(21)	5.47	(49)	3.65
Non-vested options outstanding, end of period	519	\$ 6.83	658	\$ 6.73

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	Remaining Fiscal 2009	Fiscal 2010-2011	Fiscal 2012-2013	Thereafter	Total
	(Dollars in thousands)				
Standby letters of credit	\$ 10,013	\$ 5,289	\$ 615	\$ 320	\$ 16,237
Commitments to extend credit	245,560	196,269	5,380	96,523	543,732
Total	\$ 255,573	\$ 201,558	\$ 5,995	\$ 96,843	\$ 559,969

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2009

(UNAUDITED)

8. SUBSEQUENT EVENTS

The Company adopted SFAS 165 on June 15, 2009 which requires management to evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or are available to be issued. It does not change the recognition and disclosure requirements in AU Section 560 for Type I and Type II subsequent events; however, SFAS 165 refers to them as recognized (Type I) and nonrecognized subsequent events (Type II). The Company must consider supplementing historical financial statements with the pro forma impact of nonrecognized subsequent events if the event is so significant that disclosure of the event could be best made through the use of pro forma financial data. Statement 165 is effective prospectively for interim or annual financial periods ending after June 15, 2009. The adoption of this pronouncement did not have a significant impact on the Company's financial statements. The Company evaluated all events and transactions that occurred after the balance sheet date through August 10, 2009 and determined no reportable subsequent events existed.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Special Cautionary Notice Regarding Forward-Looking Statements

Statements and financial discussion and analysis contained in this quarterly report on Form 10-Q that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond the Company's control. Many possible events or factors could affect the future financial results and performance of the Company and could cause such results or performance to differ materially from those expressed in the forward-looking statements. These possible events or factors include, without limitation:

changes in the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations resulting in, among other things, a deterioration in credit quality or reduced demand for credit, including the result and effect on the Company's loan portfolio and allowance for credit losses;

changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations;

changes in the levels of loan prepayments and the resulting effects on the value of the Company's loan portfolio;

changes in local economic and business conditions which adversely affect the Company's customers and their ability to transact profitable business with the company, including the ability of the Company's borrowers to repay their loans according to their terms or a change in the value of the related collateral;

increased competition for deposits and loans adversely affecting rates and terms;

the timing, impact and other uncertainties of any future acquisitions, including the Company's ability to identify suitable future acquisition candidates, the success or failure in the integration of their operations, and the ability to enter new markets successfully and capitalize on growth opportunities;

the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on the results of operations;

increased credit risk in the Company's assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio;

the failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses;

changes in the availability of funds resulting in increased costs or reduced liquidity;

a deterioration or downgrade in the credit quality and credit agency ratings of the securities in the Company's securities portfolio;

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increased asset levels and changes in the composition of assets and the resulting impact on the Company's capital levels and regulatory capital ratios;

the Company's ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;

the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels;

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government intervention in the U.S. financial system;

changes in statutes and government regulations or their interpretations applicable to financial holding companies and the Company's present and future banking and other subsidiaries, including changes in tax requirements and tax rates;

acts of terrorism, an outbreak of hostilities or other international or domestic calamities, weather or other acts of God and other matters beyond the Company's control; and

other risks and uncertainties listed from time to time in the Company's reports and documents filed with the Securities and Exchange Commission.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. The Company believes it has chosen these assumptions or bases in good faith and that they are reasonable. However, the Company cautions you that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. The Company undertakes no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company's interim consolidated financial statements and accompanying notes. This section should be read in conjunction with the Company's interim consolidated financial statements and accompanying notes included elsewhere in this report and with the consolidated financial statements and accompanying notes and other detailed information appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

OVERVIEW

The Company, a Texas corporation, was formed in 1983 as a vehicle to acquire the former Allied First Bank in Edna, Texas which was chartered in 1949 as The First National Bank of Edna. The Company is a registered financial holding company that derives substantially all of its revenues and income from the operation of its bank subsidiary, Prosperity Bank® (Prosperity Bank or the Bank). The Bank provides a wide array of financial products and services to small and medium-sized businesses and consumers. As of June 30, 2009, the Bank operated one hundred fifty-eight (158) full-service banking locations; with fifty-one (51) in the Greater Houston Consolidated Metropolitan Statistical Area (CMSA), twenty-seven (27) in the South Texas area including Corpus Christi and Victoria, thirty-six (36) in the Central Texas area including Austin and Bryan/College Station,, twenty (20) in East Texas and twenty-four (24) in the Dallas/Fort Worth, Texas area. The Greater Houston CMSA includes Austin, Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, San Jacinto and Waller counties. The Company's headquarters are located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (281) 269-7199. The Company's website address is www.prosperitybanktx.com. Information contained on the Company's website is not incorporated by reference into this quarterly report on Form 10-Q and is not part of this or any other report.

The Company generates the majority of its revenues from interest income on loans, service charges on customer accounts and income from investment in securities. The revenues are partially offset by interest expense paid on deposits and other borrowings and noninterest expenses such as administrative and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings which are used to fund those assets. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and margin.

Three principal components of the Company's growth strategy are internal growth, stringent cost control practices and strategic merger transactions. The Company focuses on continual internal growth. Each banking center is operated as a separate profit center, maintaining separate data with respect to its net interest income, efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. The Company also focuses on maintaining stringent cost control practices and policies. The Company has invested significantly in the infrastructure required to centralize many of its critical operations, such as data processing and loan processing. Management believes that this centralized infrastructure can accommodate substantial additional growth while enabling the Company to minimize operational costs through certain economies of scale. The Company also intends to continue to seek expansion opportunities. On January 10, 2008, the Company purchased six (6) branches of Banco Popular North America. On June 1, 2008 the Company purchased 1st Choice Bancorp, Inc. (the 1st Choice acquisition) which added one (1) banking center after consolidation. On November 7, 2008, the Bank assumed approximately \$3.6 billion of deposits and acquired certain assets from the Federal Deposit Insurance Corporation (FDIC), acting in its capacity as

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receiver for Franklin Bank (the Franklin acquisition or the Franklin Bank acquisition). The transaction added thirty-three (33) banking centers after consolidations with existing Prosperity Bank locations.

Total assets were \$8.84 billion at June 30, 2009 compared with \$9.07 billion at December 31, 2008, a decrease of \$233.8 million or 2.6%. Total loans were \$3.45 billion at June 30, 2009 compared with \$3.57 billion at December 31, 2008, a decrease of \$115.7 million or 3.2%. Total deposits were \$7.26 billion at June 30, 2009 compared with \$7.30 billion December 31, 2008, a decrease of \$45.4 million or 0.6%. Shareholders equity increased \$43.6 million or 3.5%, to \$1.30 billion at June 30, 2009 compared with \$1.26 billion at December 31, 2008.

CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are integral to understanding the financial results reported. Accounting policies are described in detail in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity:

Allowance for Credit Losses The allowance for credit losses is established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses inherent in the Company's loan portfolio. Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for credit losses to the Bank's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers factors such as historical loan loss experience, industry diversification of the Company's commercial loan portfolio, the amount of nonperforming assets and related collateral, the volume, growth and composition of the Company's loan portfolio, current economic changes that may affect the borrower's ability to pay and the value of collateral, the evaluation of the Company's loan portfolio through its internal loan review process and other relevant factors. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. Charge-offs occur when loans are deemed to be uncollectible. The allowance for credit losses includes allowance allocations calculated in accordance with Statement of Financial Accounting Standards (SFAS) No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS 118, and allowance allocations determined in accordance with SFAS No. 5, *Accounting for Contingencies*.

Goodwill Goodwill and intangible assets that have indefinite useful lives are subject to at least an annual impairment test and more frequently if circumstances indicate their value may not be recoverable. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of each of the Company's reporting units compared with its carrying value. If the carrying amount exceeds the fair value of a reporting unit, a second test is completed comparing the implied fair value of the reporting unit's goodwill to its carrying value to measure the amount of impairment. Intangible assets that are not amortized will be tested for impairment at least annually by comparing the fair values of those assets to their carrying values. Other identifiable intangible assets that are subject to amortization are amortized on an accelerated basis over the years expected to be benefited, which the Company believes is between eight and ten years. These amortizable intangible assets are reviewed for impairment if circumstances indicate their value may not be recoverable based on a comparison of fair value to carrying value. Based on the Company's annual goodwill impairment test as of September 30, 2008, management does not believe any of its goodwill is impaired as of June 30, 2009. While the Company believes no impairment existed at June 30, 2009 under accounting standards applicable at that date, different conditions or assumptions, or changes in cash flows or profitability, if significantly negative or unfavorable, could have a material adverse effect on the outcome of the Company's impairment evaluation and financial condition or future results of operations.

Stock-Based Compensation The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with SFAS No. 123R, *Share-Based Payment (Revised 2004)* (*SFAS 123R*). SFAS 123R was effective for companies in 2006, however, the Company had been recognizing compensation expense since January 1, 2003. The Company's results of operations reflect compensation expense for all employee stock-based compensation, including the unvested portion of stock options granted prior to 2003. SFAS No. 123R requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions.

Valuation of Securities The Company's available for sale securities portfolio is reported at fair value. 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 impairment exists. Available for sale and held to maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers the

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financial condition and near-term prospects of the issuer, as well as the value of any security the Company may have in the investment. 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

Net income available to common shareholders was \$26.5 million (\$0.57 per common share on a diluted basis) for the quarter ended June 30, 2009 compared with \$23.4 million (\$0.52 per common share on a diluted basis) for the quarter ended June 30, 2008, an increase in net income of \$3.1 million or 13.1%. The Company posted returns on average common equity of 8.18% and 7.96%, returns on average assets of 1.20% and 1.43% and efficiency ratios of 48.98% and 46.50% for the quarters ended June 30, 2009 and 2008, respectively. The efficiency ratio is calculated by dividing total noninterest expense (excluding credit loss provisions) by net interest income plus noninterest income (excluding net gains and losses on the sale of securities and assets and impairment write-down on securities). Additionally, taxes are not part of this calculation.

For the six months ended June 30, 2009, net income available to common shareholders was \$52.0 million (\$1.13 per common share on a diluted basis) compared with \$46.4 million (\$1.04 per common share on a diluted basis) for the same period in 2008, an increase in net income of \$5.6 million or 12.1%. The Company posted returns on average common equity of 8.12% and 7.99%, returns on average assets of 1.17% and 1.43% and efficiency ratios of 49.22% and 45.78% for the six months ended June 30, 2009 and 2008, respectively.

Net Interest Income

The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a volume change. It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as a rate change.

Net interest income before the provision for credit losses was \$75.5 million for the quarter ended June 30, 2009 compared with \$54.0 million for the quarter ended June 30, 2008, an increase of \$21.6 million, or 39.9%. Net interest income increased as a result of an increase in average interest-earning assets to \$7.56 billion for the quarter ended June 30, 2009 compared with \$5.37 billion for the quarter ended June 30, 2008, an increase of \$2.19 billion, or 40.8%. The increase in average earning assets was primarily attributable to increases in average securities primarily attributable to the Franklin Bank acquisition.

The net interest margin on a tax equivalent basis decreased to 4.04% for the quarter ended June 30, 2009 compared with 4.10% for the quarter ended June 30, 2008. The average rate paid on interest-bearing liabilities decreased 93 basis points from 2.76% for the quarter ended June 30, 2008 compared with 1.83% for the quarter ended June 30, 2009. The average yield on earning assets decreased 69 basis points from 6.14% for the quarter ended June 30, 2008 compared with 5.45% for the quarter ended June 30, 2009. The volume of interest-bearing liabilities increased \$1.87 billion and the volume of interest-earning assets increased \$2.19 billion for the same periods.

Net interest income before the provision for credit losses increased \$43.6 million, or 41.2%, to \$149.6 million for the six months ended June 30, 2009 compared with \$106.0 million for the same period in 2008. This increase was mainly attributable to higher average interest-earning assets resulting from an increase in average loans and securities due to the Franklin Bank acquisition. The net interest margin on a tax equivalent basis decreased to 4.01% compared with 4.07% for the same periods principally due to a 102 basis point decrease in the average rate paid on interest-bearing liabilities from 2.99% for the six months ended June 30, 2008 compared with 1.97% for the six months ended June 30, 2009 and a 77 basis point decrease in the average yield on earning assets from 6.30% for the six months ended June 30, 2008 compared with 5.53% for the six months ended June 30, 2009.

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The following tables set forth, for each category of interest-earning assets and interest-bearing liabilities, the average amounts outstanding, the interest earned or paid on such amounts, and the average rate earned or paid for the three and the six month periods ended June 30, 2009 and 2008. The tables also set forth the average rate paid on total interest-bearing liabilities, and the net interest margin on average total interest-earning assets for the same periods. Except as indicated in the footnotes, no tax-equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended June 30,					
	Average Outstanding Balance	2009 Interest Earned/ Paid	Average Yield/ Rate (2)	Average Outstanding Balance	2008 Interest Earned/ Paid	Average Yield/ Rate (2)
(Dollars in thousands)						
Assets						
Interest-earning assets:						
Loans	\$ 3,472,449	\$ 55,248	6.38%	\$ 3,203,305	\$ 55,948	7.02%
Securities (1)	3,964,766	47,450	4.79	2,131,370	25,856	4.85
Federal funds sold and other temporary investments	122,358	70	0.23	33,803	175	2.08
Total interest-earning assets	7,559,573	102,768	5.45%	5,368,478	81,979	6.14%
Less allowance for credit losses	(39,249)			(32,813)		
Total interest-earning assets, net of allowance	7,520,324			5,335,665		
Noninterest-earning assets	1,313,661			1,203,599		
Total assets	\$ 8,833,985			\$ 6,539,264		
Liabilities and shareholders equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 1,047,363	\$ 2,182	0.84%	\$ 745,413	\$ 1,652	0.89%
Savings and money market accounts	1,878,238	4,619	0.99	1,370,964	6,678	1.96
Certificates of deposit	2,820,910	18,820	2.68	1,708,251	16,880	3.97
Junior subordinated debentures	92,265	959	4.17	102,575	1,558	6.11
Federal funds purchased and other borrowings	28,937	387	5.36	76,132	666	3.52
Securities sold under repurchase agreements	92,466	280	1.21	82,408	574	2.80
Total interest-bearing liabilities	5,960,179	27,247	1.83%	4,085,743	28,008	2.76%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	1,499,888			1,215,176		
Other liabilities	78,181			61,187		
Total liabilities	7,538,248			5,362,106		
Shareholders equity	1,295,737			1,177,158		
Total liabilities and shareholders equity	\$ 8,833,985			\$ 6,539,264		
Net interest rate spread			3.62%			3.38%
Net interest income and margin (3)		\$ 75,521	4.01%		\$ 53,971	4.04%
Net interest income and margin (tax-equivalent basis) (4)		\$ 76,226	4.04%		\$ 54,692	4.10%

- (1) Yield is based on amortized cost and does not include any component of unrealized gains or losses.
- (2) Annualized.
- (3) The net interest margin is equal to net interest income divided by average interest-earning assets.
- (4) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 35%.

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	Average Outstanding Balance	Six Months Ended June 30,			2008 Interest Earned/ Paid	Average Yield/ Rate (2)
		2009 Interest Earned/ Paid	Average Yield/ Rate (2)	Average Outstanding Balance		
Assets						
Interest-earning assets:						
Loans	\$ 3,501,488	\$ 111,050	6.40%	\$ 3,173,240	\$ 114,468	7.25%
Securities (1)	3,997,278	97,178	4.86	2,054,440	50,639	4.93
Federal funds sold and other temporary investments	94,631	106	0.23	82,702	1,337	3.25
Total interest-earning assets	7,593,397	208,334	5.53%	5,310,382	166,444	6.30%
Less allowance for credit losses	(38,240)			(32,381)		
Total interest-earning assets, net of allowance	7,555,157			5,278,001		
Noninterest-earning assets	1,307,993			1,199,982		
Total assets	\$ 8,863,150			\$ 6,477,983		
Liabilities and shareholders equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 1,058,122	\$ 4,304	0.82%	\$ 807,570	\$ 4,773	1.19%
Savings and money market accounts	1,841,147	10,676	1.17	1,311,655	14,092	2.16
Certificates of deposit	2,868,186	40,098	2.82	1,684,444	35,290	4.21
Junior subordinated debentures	92,265	2,078	4.54	106,012	3,577	6.79
Federal funds purchased and other borrowings	55,865	951	3.43	86,554	1,568	3.64
Securities sold under repurchase agreements	88,128	628	1.44	74,241	1,178	3.19
Total interest-bearing liabilities	6,003,713	58,735	1.97%	4,070,476	60,478	2.99%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	1,498,136			1,184,121		
Other liabilities	80,101			63,032		
Total liabilities	7,581,950			5,317,629		
Shareholders equity	1,281,200			1,160,354		
Total liabilities and shareholders equity	\$ 8,863,150			\$ 6,477,983		
Net interest rate spread			3.56%			3.31%
Net interest income and margin (3)		\$ 149,599	3.97%		\$ 105,966	4.01%
Net interest income and margin (tax-equivalent basis) (4)		\$ 150,985	4.01%		\$ 107,524	4.07%

(1) Yield is based on amortized cost and does not include any component of unrealized gains or losses.

(2) Annualized.

(3) The net interest margin is equal to net interest income divided by average interest-earning assets.

(4) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 35%.

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The following tables present the dollar amount of changes in interest income and interest expense for the major components of interest-earning assets and interest-bearing liabilities and distinguishes between the increase (decrease) related to changes in outstanding balances and the volatility of interest rates. For purposes of these tables, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

	Three Months Ended June 30, 2009 vs. 2008		
	Increase (Decrease)		
	Due to		
	Volume	Rate	Total
	(In thousands)		
Interest-earning assets:			
Loans	\$ 4,701	\$ (5,401)	\$ (700)
Securities	22,241	(647)	21,594
Federal funds sold and other temporary investments	458	(563)	(105)
Total increase (decrease) in interest income	27,400	(6,611)	20,789
Interest-bearing liabilities:			
Interest-bearing demand deposits	669	(139)	530
Savings and money market accounts	2,471	(4,530)	(2,059)
Certificates of deposit	10,995	(9,055)	1,940
Junior subordinated debentures	(157)	(442)	(599)
Federal funds purchased and other borrowings	(413)	134	(279)
Securities sold under repurchase agreements	70	(364)	(294)
Total increase (decrease) in interest expense	13,635	(14,396)	(761)
Increase in net interest income	\$ 13,765	\$ 7,785	\$ 21,550

	Six Months Ended June 30, 2009 vs. 2008		
	Increase (Decrease)		
	Due to		
	Volume	Rate	Total
	(In thousands)		
Interest-earning assets:			
Loans	\$ 11,841	\$ (15,259)	\$ (3,418)
Securities	47,888	(1,349)	46,539
Federal funds sold and other temporary investments	193	(1,424)	(1,231)
Total increase (decrease) in interest income	59,922	(18,032)	41,890
Interest-bearing liabilities:			
Interest-bearing demand deposits	1,481	(1,950)	(469)
Savings and money market accounts	5,689	(9,105)	(3,416)
Certificates of deposit	24,800	(19,992)	4,808
Junior subordinated debentures	(464)	(1,035)	(1,499)
Federal funds purchased and other borrowings	(556)	(61)	(617)
Securities sold under repurchase agreements	220	(770)	(550)

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Total increase (decrease) in interest expense	31,170	(32,913)	(1,743)
Increase in net interest income	\$ 28,752	\$ 14,881	\$ 43,633

Table of Contents*Provision for Credit Losses*

Management actively monitors the Company's asset quality and provides specific loss provisions when necessary. Provisions for credit losses are charged to income to bring the total allowance for credit losses to a level deemed appropriate by management of the Company based on such factors as historical credit loss experience, industry diversification of the Company's commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume growth and composition of the loan portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the loan portfolio through the internal loan review process and other relevant factors.

Loans are charged-off against the allowance for credit losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for credit losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations.

The Company made a \$6.9 million provision for credit losses for the quarter ended June 30, 2009 and a \$1.0 million provision for the quarter ended June 30, 2008. The increase was due to an increase in net charge-offs to \$3.5 million for the quarter ended June 30, 2009 compared with net charge-offs of \$1.2 million for the quarter ended June 30, 2008. The Company made a \$13.0 million provision for credit losses for the six months ended June 30, 2009 and a \$2.2 million provision for the six months ended June 30, 2008. The increase was due to an increase in net charge-offs to \$7.4 million for the six months ended June 30, 2009 compared with \$2.8 million for the six months ended June 30, 2008.

Noninterest Income

The Company's primary sources of noninterest income are service charges on deposit accounts and other banking service related fees. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method. Banking related service fees include check cashing fees, official check fees, safe deposit box rent and currency handling fees. Noninterest income totaled \$15.1 million for the three months ended June 30, 2009 compared with \$13.1 million for the same period in 2008, an increase of \$2.1 million, or 15.8%. Noninterest income increased \$4.4 million, or 17.1%, to \$30.1 million for the six months ended June 30, 2009 compared with \$25.7 million for the same period in 2008. Both increases were primarily due to an increase in insufficient funds charges and customer service charges which resulted from an increase in the number of accounts due to the Franklin and 1st Choice acquisitions. As of June 30, 2009, approximately 108,000 deposit accounts were attributed to these two acquisitions.

The net gain on sale of ORE was \$415,000 for the three months ended June 30, 2009 compared with a net loss of \$478,000 for the three months ended June 30, 2008. The net gain on sale of ORE was \$437,000 for the six months ended June 30, 2009 compared with a net loss of \$439,000 for the same period in 2008.

Other noninterest income decreased \$72,000 or 13.1% to \$479,000 for the three months ended June 30, 2009 compared with \$551,000 for the same period in 2008. Other noninterest income increased \$591,000 or 49.9% to \$1.8 million for the six months ended June 30, 2009 compared with \$1.2 million for the same period in 2008. The increase was primarily due to loan servicing income paid by the FDIC related to loans of Franklin Bank that the Bank serviced on behalf of the FDIC but did not purchase. The loan servicing agreement ended in April 2009.

The following table presents, for the periods indicated, the major categories of noninterest income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Service charges on deposit accounts	\$ 12,863	\$ 10,727	\$ 25,235	\$ 21,233
Banking related service fees	501	484	992	923
Brokered mortgage income	140	113	210	222
Investment income	115	91	368	171
Income from leased assets	82	349	168	683
Bank owned life insurance income (BOLI)	338	443	667	904
Net gain on sale of assets	200	676	297	680
Net gain (loss) on sale of ORE	415	(478)	437	(439)
Net gain on sale of held-for-sale loans		110		183
Other noninterest income	479	551	1,776	1,185

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Total noninterest income	\$ 15,133	\$ 13,066	\$ 30,150	\$ 25,745
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Noninterest expense totaled \$44.3 million for the quarter ended June 30, 2009 compared with \$30.9 million for the quarter ended June 30, 2008, an increase of \$13.4 million or 43.6%. Noninterest expense totaled \$88.3 million for the six months ended June 30, 2009 compared with \$60.0 million for the six months ended June 30, 2008, an increase of \$28.3 million or 47.3%. Both increases occurred primarily in salaries and employee benefits, regulatory assessments and FDIC insurance and other. The following table presents, for the periods indicated, the major categories of noninterest expense:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Salaries and employee benefits (1)	\$ 20,494	\$ 16,751	\$ 43,142	\$ 32,881
Non-staff expenses:				
Net occupancy expense	3,513	2,867	7,492	5,677
Depreciation	2,069	1,920	4,070	3,857
Data processing	1,562	1,361	3,617	2,652
Communications expense	2,114	1,660	4,331	3,169
Printing and supplies	732	435	1,325	881
Professional fees	722	635	1,369	545
Regulatory assessments and FDIC insurance	5,771	287	8,752	546
Ad valorem and franchise taxes	931	685	1,874	1,361
Core deposit intangibles amortization	2,492	2,459	5,156	4,951
Other	3,900	1,800	7,195	3,460
Total non-staff expenses	23,806	14,109	45,181	27,099
Total noninterest expense	\$ 44,300	\$ 30,860	\$ 88,323	\$ 59,980

(1) Includes stock based compensation expense of \$294,000 and \$393,000 for the three months ended June 30, 2009 and 2008, respectively, and \$620,000 and \$641,000 for the six months ended June 30, 2009 and 2008, respectively.

Salaries and employee benefit expenses were \$20.5 million for the quarter ended June 30, 2009 compared with \$16.8 million for the quarter ended June 30, 2008, an increase of \$3.7 million, or 22.3%. The increase was principally due to annual employee pay increases and the Franklin Bank and 1st Choice acquisitions. For the six months ended June 30, 2009, salaries and employee benefit expenses were \$43.1 million, an increase of \$10.3 million or 31.2% compared with \$32.9 million for the six months ended June 30, 2008. The increase was principally due to annual employee pay increases and the Franklin Bank and 1st Choice acquisitions. The number of full-time equivalent (FTE) associates employed by the Company was 1,634 at June 30, 2009, 1,684 at March 31, 2009 and 1,397 at June 30, 2008.

Regulatory assessments and FDIC insurance increased \$5.5 million, or 1,910.8%, to \$5.8 million for the quarter ended June 30, 2009 compared with \$287,000 during the same period in 2008. Regulatory assessments and FDIC insurance increased \$8.2 million, or 1,502.9%, to \$8.8 million for the six months ended June 30, 2009 compared with \$546,000 during the same period in 2008. The increase was due to higher rates charged by the FDIC for deposit insurance and an increase in deposits due to the Franklin acquisition. In addition to the increase in the regular FDIC assessment rates, the FDIC imposed an emergency special assessment of 5 basis points on total assets minus total Tier 1 capital as of June 30, 2009. The special assessment will be payable on September 30, 2009.

Other expense increased \$2.1 million from \$1.8 million or 116.8%, for the three months ended June 30, 2008 to \$3.9 million for the three months ended June 30, 2009. Other expense increased \$3.7 million from \$3.5 million, or 107.9%, for the six months ended June 30, 2008 compared with \$7.2 million for the six months ended June 30, 2009. The increases were primarily due to increased general operating expenses related to the banking centers acquired in the Franklin and 1st Choice acquisitions.

Table of Contents*Income Taxes*

Income tax expense increased \$1.2 million or 10.3% to \$12.9 million for the quarter ended June 30, 2009 compared with \$11.7 million for the same period in 2008. For the six months ended June 30, 2009, income tax expense totaled \$26.4 million, an increase of \$3.2 million or 13.9% compared with \$23.2 million for the same period in 2008. The increase was primarily attributable to higher pretax net earnings for the three and six months ended June 30, 2009 compared with the same respective periods in 2008. The effective tax rate for the three months ended June 30, 2009 and 2008 was 32.8% and 33.4%, respectively. The effective tax rate for the six months ended June 30, 2009 and 2008 was 33.7% and 33.3%, respectively.

FINANCIAL CONDITION*Loan Portfolio*

Total loans were \$3.45 billion at June 30, 2009, a decrease of \$115.7 million or 3.2% compared with \$3.57 billion at December 31, 2008.

The following table summarizes the loan portfolio of the Company by type of loan as of June 30, 2009 and December 31, 2008:

	June 30, 2009		December 31, 2008	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial and industrial	\$ 436,986	12.7%	\$ 482,476	13.5%
Real estate:				
Construction and land development	613,386	17.8	666,081	18.7
1-4 family residential	675,702	19.6	668,097	18.7
Home equity	115,029	3.3	107,048	3.0
Commercial mortgages	1,246,832	36.1	1,268,340	35.6
Farmland	94,453	2.7	96,970	2.7
Multifamily residential	71,657	2.1	75,063	2.1
Agriculture	55,062	1.6	48,679	1.3
Consumer (net of unearned discount)	117,579	3.4	137,639	3.9
Other	24,633	0.7	16,664	0.5
Total loans	\$ 3,451,319	100.0%	\$ 3,567,057	100.0%

Nonperforming Assets

The Company had \$19.6 million in nonperforming assets at June 30, 2009 and \$14.4 million in nonperforming assets at December 31, 2008, an increase of \$5.2 million or 36.3%. The ratio of nonperforming assets to loans and other real estate was 0.57% at June 30, 2009 compared with 0.40% at December 31, 2008.

The Company generally places a loan on nonaccrual status and ceases accruing interest when the payment of principal or interest is delinquent for 90 days, or earlier in some cases, unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan. The Company generally charges off all loans before attaining nonaccrual status.

The following table presents information regarding nonperforming assets as of the dates indicated:

	June 30, 2009	December 31, 2008
	(Dollars in thousands)	
Nonaccrual loans	\$ 646	\$ 2,142

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Restructured loans		
Accruing loans 90 or more days past due	7,497	7,594
Total nonperforming loans	8,143	9,736
Repossessed assets	343	182
Other real estate	11,101	4,450
Total nonperforming assets	\$ 19,587	\$ 14,368
Nonperforming assets to total loans and other real estate	0.57%	0.40%
Nonperforming assets to average earning assets	0.26%	0.25%

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The following table presents information regarding nonperforming assets by type as of the dates indicated:

	June 30, 2009	December 31, 2008
	(Dollars in thousands)	
Commercial	\$ 955	\$ 1,491
Construction	10,969	9,252
1-4 family (including home equity)	1,353	1,325
Commercial real estate (including multi-family)	6,157	2,014
Agriculture and agriculture real estate		30
Consumer	153	250
Other		6
 Total nonperforming assets	 \$ 19,587	 \$ 14,368

Allowance for Credit Losses

Management actively monitors the Company's asset quality and provides specific loss allowances when necessary. Loans are charged-off against the allowance for credit losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations. As of June 30, 2009, the allowance for credit losses amounted to \$42.6 million or 1.23% of total loans compared with \$37.0 million or 1.04% of total loans at December 31, 2008.

Set forth below is an analysis of the allowance for credit losses for the six months ended June 30, 2009 and the year ended December 31, 2008:

	Six Months Ended June 30, 2009	Year Ended December 31, 2008
	(Dollars in thousands)	
Average loans outstanding	\$ 3,501,488	\$ 3,250,447
 Gross loans outstanding at end of period	 \$ 3,451,319	 \$ 3,567,057
 Allowance for credit losses at beginning of period	 \$ 36,970	 \$ 32,543
Balance acquired with acquisitions		2,182
Provision for credit losses	13,025	9,867
Charge-offs:		
Commercial and industrial	(1,194)	(2,799)
Real estate and agriculture	(5,443)	(3,650)
Consumer	(1,546)	(2,733)
Recoveries:		
Commercial and industrial	125	308
Real estate and agriculture	153	220
Consumer	521	1,032
 Net charge-offs	 (7,384)	 (7,622)
 Allowance for credit losses at end of period	 \$ 42,611	 \$ 36,970
 Ratio of allowance to end of period loans	 1.23%	 1.04%

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Ratio of net charge-offs to average loans (annualized)	0.42%	0.23%
Ratio of allowance to end of period nonperforming loans	523.3%	379.7%

Table of Contents*Securities*

The carrying cost of securities totaled \$3.98 billion at June 30, 2009 compared with \$4.16 billion at December 31, 2008, a decrease of \$179.3 million or 4.3%. At June 30, 2009, securities represented 45.0% of total assets compared with 45.9% of total assets at December 31, 2008.

The following table summarizes the amortized cost of securities as of the dates shown (available-for-sale securities are not adjusted for unrealized gains or losses):

	June 30, 2009	December 31, 2008
	(Dollars in thousands)	
U.S. Treasury securities and obligations of U.S. government agencies	\$ 49,718	\$ 151,147
States and political subdivisions	83,874	84,569
Corporate debt securities	3,224	3,221
Collateralized mortgage obligations	148,424	179,389
Mortgage-backed securities	3,660,428	3,711,629
Qualified Zone Academy Bond (QZAB)	8,000	8,000
Equity securities	7,288	7,288
Total amortized cost	\$ 3,960,956	\$ 4,145,243
Total fair value	\$ 4,061,206	\$ 4,226,225

Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. However, certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transfer in Securitized Financial Assets*. The Company currently does not own any securities that are accounted for under EITF 99-20.

In determining OTTI under the SFAS No. 115 model, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. If applicable, the second segment of the portfolio uses the OTTI guidance provided by EITF 99-20 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the EITF 99-20 model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors shall be recognized in other comprehensive income, net of

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applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment.

Management believes they do not intend to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery, at which time the Company will receive full value for the securities. Furthermore, management has the ability and intent to hold the securities classified as available for sale that were in a loss position as of June 30, 2009 for a period of time sufficient for an entire recovery of the cost basis of the securities. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of June 30, 2009, management believes any impairment in the Company's securities are temporary and no impairment loss has been realized in the Company's consolidated income statement.

The following tables present the amortized cost and fair value of securities classified as available for sale at June 30, 2009:

	Amortized Cost	June 30, 2009		Fair Value
		Gross Unrealized Gains (Dollars in thousands)	Gross Unrealized Losses	
U.S. Treasury securities and obligations of U.S. government agencies.	\$ 1,021	\$ 32	\$	\$ 1,053
States and political subdivisions (including QZAB)	57,286	849	(791)	57,344
Corporate debt securities and other	9,012	16		9,028
Collateralized mortgage obligations	1,298		(24)	1,274
Mortgage-backed securities	570,201	20,186	(115)	590,272
Total	\$ 638,818	\$ 21,083	\$ (930)	\$ 658,971

The following tables present the amortized cost and fair value of securities classified as held-to-maturity at June 30, 2009:

	Amortized Cost	June 30, 2009		Fair Value
		Gross Unrealized Gains (Dollars in thousands)	Gross Unrealized Losses	
U.S. Treasury securities and obligations of U.S. government agencies.	\$ 48,697	\$ 1,836	\$	\$ 50,533
States and political subdivisions	34,588	401	(1,420)	33,569
Corporate debt securities	1,500		(19)	1,481
Collateralized mortgage obligations	147,126	2,277	(1,683)	147,720
Mortgage-backed securities	3,090,227	80,307	(1,602)	3,168,932
Total	\$ 3,322,138	\$ 84,821	\$ (4,724)	\$ 3,402,235

Table of Contents*Premises and Equipment*

Premises and equipment, net of accumulated depreciation, totaled \$149.7 million and \$123.6 million at June 30, 2009 and December 31, 2008, respectively, an increase of \$26.1 million or 21.1%. The increase was primarily due to the former Franklin Bank locations that were not acquired by the Bank until the first quarter of 2009 and totaled \$29.3 million.

Deposits

Total deposits were \$7.26 billion at June 30, 2009 compared with \$7.30 billion at December 31, 2008, a decrease of \$45.4 million or 0.6%. At June 30, 2009, noninterest-bearing deposits accounted for approximately 20.3% of total deposits compared with 20.9% of total deposits at December 31, 2008. Interest-bearing demand deposits totaled \$5.78 billion or 79.7% of total deposits at June 30, 2009 compared with \$5.78 billion or 79.1% of total deposits at December 31, 2008.

The following table summarizes the daily average balances and weighted average rates paid on deposits for the periods presented below:

	Six Months Ended June 30, 2009		Year Ended December 31, 2008	
	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)			
Interest-bearing demand	\$ 1,058,122	0.82%	\$ 791,739	1.01%
Regular savings	318,036	0.62	253,090	0.74
Money market savings	1,523,111	1.29	1,158,052	2.24
Time deposits	2,868,186	2.82	1,997,152	3.60
Total interest-bearing deposits	5,767,455	1.93	4,200,033	2.56
Noninterest-bearing deposits	1,498,136		1,271,408	
Total deposits	\$ 7,265,591	1.53%	\$ 5,471,441	1.97%

Other Borrowings

The Company utilizes borrowings to supplement deposits to fund its lending and investment activities. Borrowings consist of funds from the Federal Home Loan Bank (FHLB) and correspondent banks. FHLB advances are considered short-term, overnight borrowings. At June 30, 2009, the Company had no FHLB advances and \$28.2 million in FHLB long-term notes payable compared with \$200.0 million in FHLB advances and \$29.4 million in FHLB long-term notes payable at December 31, 2008. The weighted average interest rate paid on the FHLB notes payable at period end was 5.4%. The maturity dates on the FHLB notes payable range from the years 2009 to 2028 and have interest rates ranging from 3.08% to 6.10%. The highest outstanding balance of FHLB advances during 2009 was \$230.0 million compared with \$280.0 million during 2008. The Company had no federal funds purchased at June 30, 2009 or December 31, 2008.

At June 30, 2009, the Company had \$96.7 million in securities sold under repurchase agreements compared with \$96.0 million at December 31, 2008, an increase of \$715,000 or 0.74%. The increase was due to normal customer activity.

The following table presents the Company's borrowings at June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
	(Dollars in thousands)	
FHLB advances	\$	\$ 200,000
FHLB long-term notes payable	28,170	29,395

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Total other borrowings	28,170	229,395
Federal funds purchased		
Securities sold under repurchase agreements	96,732	96,017
Total	\$ 124,902	\$ 325,412

Table of Contents*Junior Subordinated Debentures*

At June 30, 2009 and December 31, 2008, the Company had outstanding \$92.3 million in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts.

A summary of pertinent information related to the Company's eight issues of junior subordinated debentures outstanding at June 30, 2009 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate ⁽¹⁾	Junior Subordinated Debt Owed to Trusts	Maturity Date ⁽²⁾
Prosperity Statutory Trust II			3 month LIBOR		
	July 31, 2001	\$ 15,000,000	+ 3.58%, not to exceed 12.50%	\$ 15,464,000	July 31, 2031
Prosperity Statutory Trust III	Aug. 15, 2003	12,500,000	3 month LIBOR + 3.00% ⁽³⁾	12,887,000	Sept. 17, 2033
Prosperity Statutory Trust IV	Dec. 30, 2003	12,500,000	3 month LIBOR + 2.85% ⁽⁴⁾	12,887,000	Dec. 30, 2033
SNB Capital Trust IV ⁽⁵⁾	Sept. 25, 2003	10,000,000	3 month LIBOR + 3.00%	10,310,000	Sept. 25, 2033
TXUI Statutory Trust I ⁽⁶⁾	Sept. 07, 2000	7,000,000	10.60%	7,210,000	Sept. 07, 2030
TXUI Statutory Trust II ⁽⁶⁾	Dec. 19, 2003	5,000,000	3 month LIBOR + 2.85% ⁽⁷⁾	5,155,000	Dec. 19, 2033
TXUI Statutory Trust III ⁽⁶⁾	Nov. 30, 2005	15,500,000	3 month LIBOR + 1.39%	15,980,000	Dec. 15, 2035
TXUI Statutory Trust IV ⁽⁶⁾	Mar. 31, 2006	12,000,000	3 month LIBOR + 1.39%	12,372,000	June 30, 2036

(1) The 3-month LIBOR in effect as of June 30, 2009 was 0.595%.

(2) All debentures are callable five years from issuance date except for TXUI Statutory Trust I which is callable ten years from issuance date.

(3) The debentures bore a fixed interest rate of 6.50% until September 17, 2008, when the rate began to float on a quarterly basis based on the 3-month LIBOR plus 3.00%.

(4) The debentures bore a fixed interest rate of 6.50% until December 30, 2008, when the rate began to float on a quarterly basis based on the 3-month LIBOR plus 2.85%.

(5) Assumed in connection with the SNB acquisition on April 1, 2006.

(6) Assumed in connection with the TXUI acquisition on January 31, 2007.

(7) The debentures bore a fixed interest rate until January 23, 2009, when the rate began to float on a quarterly basis based on the 3-month LIBOR plus 2.85%.

Liquidity

Liquidity involves the Company's ability to raise funds to support asset growth or reduce assets to meet deposit withdrawals and other payment obligations, to maintain reserve requirements and otherwise to operate the Company on an ongoing basis. The Company's largest source of funds is deposits and its largest use of funds is loans. The Company does not expect a change in the source or use of its funds in the future. Although access to purchased funds from correspondent banks is available and has been utilized on occasion to take advantage of investment opportunities, the Company does not generally rely on these external funding sources. The cash and federal funds sold position, supplemented by amortizing investment and loan portfolios, has generally created an adequate liquidity position.

As of June 30, 2009, the Company had outstanding \$543.7 million in commitments to extend credit and \$16.2 million in commitments associated with outstanding standby letters of credit. Since commitments associated with letters of credit and

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commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

The Company has no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. As of June 30, 2009, the Company had cash and cash equivalents of \$271.3 million compared with \$228.6 million at December 31, 2008, an increase of \$42.7 million. The increase was primarily due to net repayments of other borrowings of \$200.0 million, a decrease in deposits of \$51.8 million, purchases of securities of \$953.0 million, purchases of premises and equipment of \$31.1 million and a decrease in other liabilities of \$30.4 million, partially offset by proceeds from the maturities and repayments of securities of \$1.14 billion, a decrease in loans of \$91.2 million, net earnings of \$52.0 million, proceeds from the sale of bank premises, equipment and ORE of \$12.9 million and a decrease in other assets of \$10.7 million.

Contractual Obligations

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of June 30, 2009 (other than deposit obligations). The payments do not include pre-payment options that may be available to the Company. The Company's future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, FHLB notes payable and operating leases as of June 30, 2009 are summarized below. Payments for junior subordinated debentures include interest of \$82.3 million that will be paid over the future periods. The future interest payments were calculated using the current rate in effect at June 30, 2009. With respect to floating interest rates, the payments were determined based on the 3-month LIBOR in effect at June 30, 2009. The current principal balance of the junior subordinated debentures at June 30, 2009 was \$92.3 million. Payments for FHLB notes payable include interest of \$5.8 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	Remaining Fiscal 2009	Fiscal 2010-2011	Payments due in:		Total
			Fiscal 2012-2013	Thereafter	
			(Dollars in thousands)		
Junior subordinated debentures	\$ 1,743	\$ 6,974	\$ 6,974	\$ 158,893	\$ 174,584
Federal Home Loan Bank notes payable	1,842	15,703	3,356	13,048	33,949
Operating leases	2,271	6,891	4,597	1,925	15,684
Total	\$ 5,856	\$ 29,568	\$ 14,927	\$ 173,866	\$ 224,217

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in its consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company's commitments associated with outstanding standby letters of credit and commitments to extend credit as of June 30, 2009 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Remaining Fiscal 2009	Fiscal 2010-2011	Fiscal 2012-2013	Thereafter	Total
Standby letters of credit	\$ 10,013	\$ 5,289	\$ 615	\$ 320	\$ 16,237
Commitments to extend credit	245,560	196,269	5,380	96,523	543,732
Total	\$ 255,573	\$ 201,558	\$ 5,995	\$ 96,843	\$ 559,969

Capital Resources

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Total shareholders' equity was \$1.30 billion at June 30, 2009 compared with \$1.26 billion at December 31, 2008, an increase of \$43.6 million or 3.5%. The increase was due primarily to net earnings of \$52.0 million and an increase in unrealized

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gain on available for sale securities of \$3.2 million, partially offset by dividends paid of \$12.7 million for the six months ended June 30, 2009.

Both the Board of Governors of the Federal Reserve System, with respect to the Company, and the Federal Deposit Insurance Corporation (FDIC), with respect to the Bank, have established certain minimum risk-based capital standards that apply to bank holding companies and federally insured banks. As of June 30, 2009, the Company's Tier 1 risk-based capital, total risk-based capital and leverage capital ratios were 11.24%, 12.28% and 5.81%, respectively. As of June 30, 2009, the Bank's risk-based capital ratios were above the levels required for the Bank to be designated as well capitalized by the FDIC, with Tier-1 risk-based capital, total risk-based capital and leverage capital ratios of 10.97%, 12.02% and 5.66%, respectively.

The Bank is participating in the deposit insurance component of the FDIC Temporary Liquidity Guarantee Program (TGLP), which increases deposit insurance on noninterest-bearing transaction account deposits on balances above \$250,000 through December 31, 2013. The Company and the Bank elected to not participate in the U.S. Department of Treasury Capital Purchase Program, which is a part of the Troubled Asset Relief Program.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages market risk, which for the Company is primarily interest rate risk, through its Asset Liability Committee which is composed of senior officers of the Company, in accordance with policies approved by the Company's Board of Directors.

The Company uses simulation analysis to examine the potential effects of market changes on net interest income and market value. The Company considers macroeconomic variables, Company strategy, liquidity and other factors as it quantifies market risk. See the Company's Annual Report on Form 10-K, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations-Interest Rate Sensitivity and Liquidity which was filed on March 2, 2009 for further discussion.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) were effective as of the end of the period covered by this report.

Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company and the Bank are defendants, from time to time, in legal actions arising from transactions conducted in the ordinary course of business. The Company and Bank believe, after consultations with legal counsel, that the ultimate liability, if any, arising from such actions will not have a material adverse effect on their consolidated financial statements.

Table of Contents**ITEM 1A. RISK FACTORS**

There have been no material changes in the Company's risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- a. Not applicable
- b. Not applicable
- c. Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

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

On April 21, 2009, the Company held its Annual Meeting of Shareholders to consider and act upon the items listed below:

1. James A. Bouligny, Robert Steelhammer and H.E. Timanus, Jr. were elected as Class II directors to serve on the Board of Directors of the Company until the Company's 2012 Annual Meeting of Shareholders and until their successors are duly elected and qualified, or until their earlier resignation or removal. Ervan Zouzalik was elected as a Class III director to serve on the Board of Directors of the Company until the Company's 2010 Annual Meeting of Shareholders and until his successor is duly elected and qualified, or until his earlier resignation or removal. The table below contains a summary of shares voted for or withheld for each nominated director:

	For	Withheld
James A. Bouligny	29,943,356	10,277,548
Robert Steelhammer	29,945,367	10,275,538
H.E. Timanus, Jr.	29,785,399	10,435,506
Ervan E. Zouzalik	30,447,859	9,773,045

The following Class I and Class III directors continued in office after the Annual Meeting: William H. Fagan, Leah Henderson, Ned S. Holmes, Perry Mueller, Jr., DDS, James D. Rollins III, Harrison Stafford II and David Zalman.

2. The shareholders ratified the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the year ending December 31, 2009. A total of 39,785,774 shares were voted in favor of the appointment, 408,340 shares were voted against the appointment and 26,790 shares abstained from voting.

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS

a. Exhibits:

Exhibit Number	Description of Exhibit
3.1	Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (Registration No. 333-63267) (the Registration Statement))
3.2	Articles of Amendment to Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006)

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- 3.3 Amended and Restated Bylaws of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 19, 2007)
- 4.1 Form of certificate representing shares of the Company's common stock (incorporated by reference to Exhibit 4 to the Registration Statement)
- 31.1* Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 31.2* Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 32.1** Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2** Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed with this Quarterly Report on Form 10-Q.

** Furnished with this Quarterly Report on Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PROSPERITY BANCSHARES, INC. ®
(Registrant)

Date: 08/10/09

/s/ David Zalman
David Zalman

Chairman and Chief Executive Officer

Date: 08/10/09

/s/ David Hollaway
David Hollaway
Chief Financial Officer