WEST BANCORPORATION INC
Form 10-Q
July 27, 2012
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012

or

o 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: 0-49677

WEST BANCORPORATION, INC.
(Exact Name of Registrant as Specified in its Charter)

IOWA	42-1230603
(State of Incorporation)	(I.R.S. Employer Identification No.)

1601 22nd Street, West Des Moines, Iowa 50266

Telephone Number: (515) 222-2300

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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

Large accelerated filer o Accelerated filer x

Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of July 26, 2012, there were 17,403,882 shares of common stock, no par value, outstanding.

WEST BANCORPORATION, INC.

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

West Bancorporation, Inc. and Subsidiary
Consolidated Balance Sheets
(unaudited)

(dollars in thousands)	June 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$36,555	$35,772
Federal funds sold and other short-term investments	76,303	51,332
Cash and cash equivalents	112,858	87,104
Securities available for sale	317,958	283,145
Federal Home Loan Bank stock, at cost	11,639	11,352
Loans held for sale	3,777	4,089
Loans	858,414	838,959
Allowance for loan losses	(15,373)	(16,778)
Loans, net	843,041	822,181
Premises and equipment, net	5,643	5,396
Accrued interest receivable	4,566	4,183
Bank-owned life insurance	25,386	25,724
Other real estate owned	9,241	10,967
Deferred tax assets	6,875	8,409
Other assets	9,035	6,974
Total assets	$1,350,019	$1,269,524
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$280,398	$268,887
Interest-bearing demand	161,770	158,141
Savings	423,254	343,312
Time of $100,000 or more	77,239	98,743
Other time	84,473	88,290
Total deposits	1,027,134	957,373
Federal funds purchased and securities sold under agreements to repurchase	60,711	55,841
Subordinated notes	20,619	20,619
Federal Home Loan Bank advances	105,000	105,000
Accrued expenses and other liabilities	6,523	7,240
Total liabilities	1,219,987	1,146,073
STOCKHOLDERS' EQUITY		
Preferred stock, $0.01 par value; authorized 50,000,000 shares; no shares issued		
and outstanding at June 30, 2012, and December 31, 2011	—	—
Common stock, no par value; authorized 50,000,000 shares; 17,403,882		
shares issued and outstanding at June 30, 2012, and December 31, 2011	3,000	3,000
Additional paid-in capital	33,702	33,687
Retained earnings	91,686	86,110
Accumulated other comprehensive income	1,644	654

Total stockholders' equity	130,032	123,451
Total liabilities and stockholders' equity	$1,350,019	$1,269,524

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Income Statements
(unaudited)

(dollars in thousands, except per share data)	Three Months Ended June 30, 2012	2011	Six Months Ended June 30, 2012	2011
Interest income:				
Loans, including fees	$11,206	$11,634	$22,396	$23,427
Securities:				
Taxable securities	1,128	1,126	2,099	2,240
Tax-exempt securities	511	570	1,014	1,174
Federal funds sold and other short-term investments	51	66	93	127
Total interest income	12,896	13,396	25,602	26,968
Interest expense:				
Demand deposits	295	409	589	829
Savings deposits	323	304	589	588
Time deposits	653	1,030	1,372	2,191
Federal funds purchased and securities sold under agreements to repurchase	29	43	66	89
Subordinated notes	186	178	379	354
Long-term borrowings	1,019	1,019	2,038	2,027
Total interest expense	2,505	2,983	5,033	6,078
Net interest income	10,391	10,413	20,569	20,890
Provision for loan losses	—	450	—	950
Net interest income after provision for loan losses	10,391	9,963	20,569	19,940
Noninterest income:				
Service charges on deposit accounts	738	805	1,468	1,555
Debit card usage fees	412	378	790	725
Trust services	190	207	394	426
Gains and fees on sales of residential mortgages	581	272	1,328	456
Increase in cash value of bank-owned life insurance	191	223	390	444
Gain from bank-owned life insurance	841	—	841	637
Investment securities impairment losses	(127)	—	(173)	—
Realized investment securities gains, net	279	—	246	—
Other income	241	231	463	544
Total noninterest income	3,346	2,116	5,747	4,787
Noninterest expense:				
Salaries and employee benefits	3,571	3,170	7,207	6,225
Occupancy	875	821	1,732	1,637
Data processing	505	479	1,006	930
FDIC insurance expense	167	346	333	895
Other real estate owned expense	906	93	988	280
Professional fees	287	237	579	459
Other expenses	1,502	1,230	2,833	2,426
Total noninterest expense	7,813	6,376	14,678	12,852
Income before income taxes	5,924	5,703	11,638	11,875
Income taxes	1,541	1,780	3,278	3,422
Net income	4,383	3,923	8,360	8,453
Preferred stock dividends and accretion of discount	—	(1,816)	—	(2,387)

Net income available to common stockholders	$4,383	$2,107	$8,360	$6,066
Basic earnings per common share	$0.25	$0.12	$0.48	$0.35
Diluted earnings per common share	$0.25	$0.12	$0.48	$0.35
Cash dividends per common share	$0.08	$0.05	$0.16	$0.05

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands)	2012	2011	2012	2011
Net income	$4,383	$3,923	$8,360	$8,453
Other comprehensive income, before tax:				
Unrealized gains (losses) on securities for which a portion of an other than temporary impairment has been recorded in earnings before tax:				
Unrealized holding gains (losses) arising during the period	(52)	155	(108)	243
Less: reclassification adjustment for impairment losses realized in net income	127	—	173	—
Net unrealized gains on securities with other than temporary impairment before tax expense	75	155	65	243
Unrealized gains on securities without other than temporary impairment before tax:				
Unrealized holding gains arising during the period	1,426	3,413	1,778	4,702
Less: reclassification adjustment for net gains realized in net income	(279)	—	(246)	—
Net unrealized gains on other securities before tax expense	1,147	3,413	1,532	4,702
Other comprehensive income before tax	1,222	3,568	1,597	4,945
Tax expense related to other comprehensive income	(464)	(1,355)	(607)	(1,879)
Other comprehensive income, net of tax:	758	2,213	990	3,066
Comprehensive income	$5,141	$6,136	$9,350	$11,519

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
(unaudited)

(dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2010	$34,508	$3,000	$34,387	$76,188	$ (2,647)	$145,436
Net income	—	—	—	8,453	—	8,453
Other comprehensive income	—	—	—	—	3,066	3,066
Preferred stock discount accretion	1,492	—	—	(1,492)	—	—
Redemption of preferred stock	(36,000)	—	—	—	—	(36,000)
Cash dividends declared, $0.05 per common share	—	—	—	(870)	—	(870)
Preferred stock dividends declared	—	—	—	(895)	—	(895)
Balance, June 30, 2011	$—	$3,000	$34,387	$81,384	$ 419	$119,190
Balance, December 31, 2011	$—	$3,000	$33,687	$86,110	$ 654	$123,451
Net income	—	—	—	8,360	—	8,360
Other comprehensive income	—	—	—	—	990	990
Cash dividends declared, $0.16 per common share	—	—	—	(2,784)	—	(2,784)
Stock-based compensation costs	—	—	15	—	—	15
Balance, June 30, 2012	$—	$3,000	$33,702	$91,686	$ 1,644	$130,032

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Cash Flows
(unaudited)

(dollars in thousands)	Six Months Ended June 30, 2012	2011
Cash Flows from Operating Activities:		
Net income	$8,360	$8,453
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	—	950
Net amortization and accretion	2,238	1,437
(Gain) loss on disposition of premises and equipment	123	(13)
Investment securities gains, net	(246)	—
Investment securities impairment losses	173	—
Stock-based compensation	15	—
Gain on sale of loans	(1,084)	(383)
Proceeds from sales of loans held for sale	53,755	23,111
Originations of loans held for sale	(52,359)	(18,349)
Gain on sale of other real estate owned	(105)	(290)
Write-down of other real estate owned	1,008	493
Gain from bank-owned life insurance	(841)	(637)
Increase in value of bank-owned life insurance	(390)	(444)
Depreciation	339	290
Deferred income taxes	927	1,076
Change in assets and liabilities:		
(Increase) decrease in accrued interest receivable	(383)	800
(Increase) decrease in other assets	(499)	1,431
Decrease in accrued expenses and other liabilities	(717)	(772)
Net cash provided by operating activities	10,314	17,153
Cash Flows from Investing Activities:		
Proceeds from sales, calls, and maturities of securities available for sale	49,103	25,320
Purchases of securities available for sale	(84,477)	(25,205)
Purchases of Federal Home Loan Bank stock	(1,226)	(456)
Proceeds from redemption of Federal Home Loan Bank stock	939	427
Net (increase) decrease in loans	(20,512)	47,267
Net proceeds from sales of other real estate owned	475	5,312
Proceeds from sales of premises and equipment	—	51
Purchases of premises and equipment	(709)	(268)
Net cash provided by (used in) investing activities	(56,407)	52,448
Cash Flows from Financing Activities:		
Net increase (decrease) in deposits	69,761	(10,139)
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	4,870	(5,573)
Net decrease in other short-term borrowings	—	(1,372)
Common stock dividends paid	(2,784)	(870)
Preferred stock dividends paid	—	(1,120)
Redemption of preferred stock	—	(36,000)
Net cash provided by (used in) financing activities	71,847	(55,074)
Net increase in cash and cash equivalents	25,754	14,527

Cash and Cash Equivalents:		
Beginning	87,104	87,954
Ending	$112,858	$102,481

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West Bancorporation, Inc. and Subsidiary
Consolidated Statements of Cash Flows (continued)
(unaudited)

	Six Months Ended June 30,	
(dollars in thousands)	2012	2011
Supplemental Disclosures of Cash Flow Information:		
Cash payments for:		
Interest	$5,214	$6,581
Income taxes	2,236	2,002
Supplemental Disclosure of Noncash Investing and Financing Activities:		
Transfer of loans to other real estate owned	$477	$1,133
Sale of other real estate owned financed by issuance of a loan	800	—
Bank-owned life insurance death benefit receivable	1,573	1,192

See accompanying Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and Subsidiary
Notes to Consolidated Financial Statements
(unaudited)
(dollars in thousands, except per share information)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by West Bancorporation, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. Although management believes that the disclosures are adequate to make the information presented understandable, it is suggested that these interim consolidated financial statements be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2011. In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the financial position as of June 30, 2012, and December 31, 2011, the net income and comprehensive income for the three and six months ended June 30, 2012 and 2011, and cash flows for the six months ended June 30, 2012 and 2011. The results for these interim periods may not be indicative of results for the entire year or for any other period.

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) established by the Financial Accounting Standards Board (FASB). References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification™, sometimes referred to as the Codification or ASC. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term are the fair value of financial instruments and other than temporary impairment (OTTI), the valuation of other real estate owned, and the allowance for loan losses.

The accompanying unaudited consolidated financial statements include the accounts of the Company, West Bank, West Bank's wholly-owned subsidiary WB Funding Corporation (which owns an interest in a partnership), and West Bank's 99.99 percent owned subsidiary ICD IV, LLC (a community development entity). All significant intercompany transactions and balances have been eliminated in consolidation. In accordance with GAAP, West Bancorporation Capital Trust I is recorded on the books of the Company using the equity method of accounting and is not consolidated.

Certain items in the financial statements as of June 30, 2011, were reclassified to be consistent with the classifications used in the June 30, 2012, financial statements. The reclassification had no effect on net income or stockholders' equity.

Current accounting developments: In April 2011, the FASB issued guidance to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This guidance removes from the assessment of effective control in the accounting for repurchase agreements (a) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (b) the collateral maintenance implementation guidance related to that criterion. The guidance was effective for the first interim and annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued amended guidance to improve the comparability of fair value measurements presented and disclosed in financial statements made in accordance with GAAP and International Financial Reporting Standards. The guidance does not extend the use of fair value accounting, but provides guidance on how it should be applied in situations where it is already required or permitted. The guidance is included in the Codification as part of ASC 820. The guidance was effective for public companies during interim and annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

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2. Critical Accounting Policies

Management has identified its most critical accounting policies to be those related to asset impairment judgments, including fair value and OTTI of available for sale investment securities, the valuation of other real estate owned, and the allowance for loan losses.

Securities available for sale are reported at fair value, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income, net of deferred income taxes. The Company evaluates each of its investment securities whose value has declined below amortized cost to determine whether the decline in fair value is OTTI. The investment portfolio is evaluated for OTTI by segregating the portfolio into two segments and applying the appropriate OTTI model. Investment securities classified as available for sale are generally evaluated for OTTI under FASB ASC 320, Investments - Debt and Equity Securities. However, certain purchased beneficial interests in securitized financial assets, including asset-backed securities and collateralized debt obligations that had credit ratings below AA at the time of purchase, are evaluated using the model outlined in FASB ASC 325, Beneficial Interests in Securitized Financial Assets.

In determining OTTI under the FASB ASC 320 model, the review takes into consideration the severity and duration of the decline in fair value, the length of time expected for recovery, the financial condition of the issuer, and other qualitative factors, as well as whether the Company intends to sell the security or whether it is more likely than not the Company will be required to sell the debt security before its anticipated recovery.

Under the FASB ASC 325 model for the second segment of the portfolio, 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 the Company intends to sell the security or whether it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI is 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 the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell before recovery of its amortized cost basis, the OTTI is 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, using the original yield as the discount rate, and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The assessment of whether an OTTI exists involves a high degree of subjectivity and judgment and is based on the information available to management at the time.

Other real estate owned includes real estate properties acquired through or in lieu of foreclosure. They are initially recorded at fair value less estimated selling costs. After foreclosure, valuations are performed by management at least annually by obtaining updated appraisals or other market information. Any subsequent write-downs are recorded as a charge to operations.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and

qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans, and other factors. Qualitative factors include the general economic environment in the Company's market areas and the expected trend of those economic conditions. While management uses the best information available to make its evaluations, future adjustments to the allowance may be necessary if there are significant changes in economic conditions or the other factors relied upon. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or less than future charge-offs.

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3. Securities Available for Sale

For securities available for sale, the following tables show the amortized cost, unrealized gains and losses (pre-tax) included in accumulated other comprehensive income, and estimated fair value by security type as of June 30, 2012, and December 31, 2011.

	June 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. government agencies and corporations	$17,624	$409	$—	$18,033
State and political subdivisions	54,205	2,708	(160)	56,753
Collateralized mortgage obligations [(1)]	195,028	2,956	(233)	197,751
Mortgage-backed securities [(1)]	41,814	1,011	—	42,825
Trust preferred securities	5,937	—	(4,039)	1,898
Corporate notes and other investments	698	—	—	698
	$315,306	$7,084	$(4,432)	$317,958

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. government agencies and corporations	$12,644	$371	$(12)	$13,003
State and political subdivisions	50,172	2,398	(53)	52,517
Collateralized mortgage obligations [(1)]	173,438	2,301	(241)	175,498
Mortgage-backed securities [(1)]	34,967	706	(37)	35,636
Trust preferred securities	6,105	—	(4,094)	2,011
Corporate notes and other investments	4,764	—	(284)	4,480
	$282,090	$5,776	$(4,721)	$283,145

(1) All collateralized mortgage obligations and mortgage-backed securities consist of residential mortgage pass-through securities guaranteed by GNMA or issued by FNMA, and real estate mortgage investment conduits guaranteed by FHLMC or GNMA.

Securities with an amortized cost of $83,318 and $96,062 as of June 30, 2012, and December 31, 2011, respectively, were pledged as collateral on securities sold under agreements to repurchase, and for other purposes as required or permitted by law or regulation. Securities sold under agreements to repurchase are held in safekeeping at a correspondent bank on behalf of the Company.

The amortized cost and fair value of securities available for sale as of June 30, 2012, by contractual maturity are shown in the following table. Certain securities have call features that allow the issuer to call the securities prior to maturity. Expected maturities may differ from contractual maturities in collateralized mortgage obligations and mortgage-backed securities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore, collateralized mortgage obligations and mortgage-backed securities are not included in the maturity categories within the summary.

	June 30, 2012	
	Amortized Cost	Fair Value
Due in one year or less	$1,052	$1,055
Due after one year through five years	21,907	22,135
Due after five years through ten years	22,402	23,825

Due after ten years	33,103	30,367
	78,464	77,382
Collateralized mortgage obligations and mortgage-backed securities	236,842	240,576
	$315,306	$317,958

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The details of the sales of securities for the three and six months ended June 30, 2012 and 2011, are summarized in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Proceeds from sales	$12,161	$—	$16,121	$—
Gross gains on sales	288	—	288	—
Gross losses on sales	9	—	42	—

The following tables show the fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position, as of June 30, 2012, and December 31, 2011.

	June 30, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)
State and political subdivisions	$7,812	$(148)	$3,130	$(12)	$10,942	$(160)
Collateralized mortgage obligations	44,366	(233)	—	—	44,366	(233)
Trust preferred securities	—	—	1,898	(4,039)	1,898	(4,039)
	$52,178	$(381)	$5,028	$(4,051)	$57,206	$(4,432)

	December 31, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)
U.S. government agencies and corporations	$4,988	$(12)	$—	$—	$4,988	$(12)
State and political subdivisions	—	—	3,090	(53)	3,090	(53)
Collateralized mortgage obligations	38,175	(241)	—	—	38,175	(241)
Mortgage-backed securities	17,898	(37)	—	—	17,898	(37)
Trust preferred securities	—	—	2,011	(4,094)	2,011	(4,094)
Corporate notes and other investments	—	—	3,708	(284)	3,708	(284)
	$61,061	$(290)	$8,809	$(4,431)	$69,870	$(4,721)

See Note 2 for a discussion of financial reporting for securities with unrealized losses. As of June 30, 2012, the available for sale investment portfolio included two municipal securities and two trust preferred securities (TPS) with unrealized losses that have existed for longer than one year.

The Company believes the unrealized losses on investments in municipal obligations as of June 30, 2012, are due to market conditions, not reduced estimated cash flows. The Company does not have the intent to sell these securities, does not anticipate that these securities will be required to be sold before anticipated recovery, and expects full principal and interest to be collected. Therefore, the Company does not consider these investments to have OTTI at June 30, 2012.

The Company believes the unrealized loss of $975 on an investment in one single-issuer TPS issued by Heartland Financial, USA, Inc. as of June 30, 2012, is due to market conditions, not reduced estimated cash flows. The Company does not have the intent to sell this security, does not anticipate that this security will be required to be sold

before anticipated recovery, and expects full principal and interest will be collected. Therefore, the Company does not consider this investment to have OTTI at June 30, 2012.

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As of June 30, 2012, the Company had one pooled TPS, ALESCO Preferred Funding X, Ltd., it considered to have OTTI. The Company engaged an independent consulting firm to assist in the valuation of this security. Based on that valuation, management determined the security had an estimated fair value of $1,137 at June 30, 2012. The consulting firm first evaluated the credit quality of each of the 77 underlying issuers within the pool by reviewing a comprehensive database of financial information and/or publicly-filed financial statements. On the basis of this information and a review of historical industry default data and current and near-term operating conditions, default and recovery probabilities for each underlying issuer within the asset were estimated. For issuers who had already defaulted, no recovery was assumed. For deferring issuers, an assumption was made that the majority of deferring issuers will continue to defer and will eventually default. Each deferring issuer is reviewed on a case-by-case basis and, in some instances, a probability is assigned that the deferral will ultimately be cured. The issuer-specific assumptions are then aggregated into cumulative weighted-average default, recovery, and prepayment probabilities. The collateral prepayment assumptions were affected by the view that the terms and pricing of TPS and subordinated debt issued by banks and insurance companies were so aggressive that it is unlikely that such financing will become available in the foreseeable future. Therefore, the assumption was made that no issuer will prepay over the life of the TPS. In light of generally weak collateral credit performance and a challenging U.S. credit and real estate environment, the assumptions generally imply more issuer defaults during the next two to three years than those that had been experienced historically, and a gradual leveling off of defaults thereafter.

In accordance with ASC 325, a discounted cash flow model was used to determine the estimated fair value of this security. The methodology for determining the appropriate discount rate for a TPS for purposes of determining fair value combines an evaluation of current market yields for comparable corporate and structured credit products with an evaluation of the risks associated with the TPS cash flows. As a result of this analysis and due to the fixed rate nature of the instrument's contractual interest cash flows, a discount rate of three-month LIBOR plus 15 percent (a lifetime average all-in discount rate of approximately 18 percent) was used for determination of fair value as of June 30, 2012, and December 31, 2011. For purposes of determining any credit loss, projected cash flows were discounted using a rate of three-month LIBOR plus 1.25 percent. Future fair value estimates for this security may vary due to changes in market interest rates and credit performance of the underlying collateral. Any additional deferrals or defaults of the underlying issuers will have a negative impact on the value of the pooled TPS, because there is no excess collateral to absorb any future defaults.

Based on the valuation work performed, an additional credit loss of $127 was recognized in second quarter 2012 earnings, bringing the year-to-date impairment to $173. No credit loss was recognized in the first half of 2011. The remaining unrealized loss of $3,064 is reflected in accumulated other comprehensive income, net of taxes of $1,164. The Company will continue to periodically estimate the present value of cash flows expected to be collected over the life of the security.

The following table provides a roll forward of the cumulative amount of credit-related losses recognized in earnings for the three and six months ended June 30, 2012 and 2011.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Balance at beginning of period	$572	$427	$526	$427
Current period credit loss recognized in earnings	127	—	173	—
Reductions for securities sold during the period	—	—	—	—
Reductions for securities where there is an intent to sell or requirement to sell	—	—	—	—
Reductions for increases in cash flows expected to be collected	—	—	—	—
Balance at end of period	$699	$427	$699	$427

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4. Loans and Allowance for Loan Losses

Loans consist of the following segments as of June 30, 2012, and December 31, 2011.

	June 30, 2012	December 31, 2011
Commercial	$260,847	$255,702
Real estate:		
Construction, land, and land development	107,655	101,607
1-4 family residential first mortgages	61,373	63,218
Home equity	23,353	26,423
Commercial	399,694	386,137
Consumer and other loans	5,662	6,155
	858,584	839,242
Net unamortized fees and costs	170	283
	$858,414	$838,959

Real estate loans of approximately $354,000 and $337,000 were pledged as security for Federal Home Loan Bank (FHLB) advances as of June 30, 2012, and December 31, 2011, respectively.

Loans are stated at the principal amounts outstanding, net of unamortized loan fees and costs, with interest income recognized on the interest method based upon those outstanding loan balances. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Loans are reported by the segments identified above and are analyzed by management on this basis and are not further broken down by class. All loan policies identified below apply to all segments of the loan portfolio.

Delinquencies are determined based on the payment terms of the individual loan agreements. The accrual of interest on past due and other impaired loans is generally discontinued at 90 days or when, in the opinion of management, the borrower may be unable to make all contractual payments pursuant to contractual terms. Unless considered collectible, all interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income, if accrued in the current year, or charged to the allowance for loan losses, if accrued in the prior year. Generally, all payments received while a loan is on nonaccrual status are applied to the principal balance of the loan. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is classified as a troubled debt restructured (TDR) loan when the Company concludes that a borrower is experiencing financial difficulties and a concession was granted that would not otherwise be considered. Concessions may include a restructuring of the terms of a loan to alleviate the burden on the borrower's cash requirements, such as an extension of the payment terms beyond the original maturity date or a change in the interest rate charged. TDR loans with extended payment terms are accounted for as impaired until performance is established. A change to the interest rate would change the classification of a loan to a TDR loan if the restructured loan yields a rate which is below a market rate for that of a new loan with comparable risk. TDR loans with below market rates are considered impaired until fully collected. TDR loans may be reported as nonaccrual or past due 90 days, rather than as a TDR loan, if they are not performing per the restructured terms.

Based upon its ongoing assessment of credit quality within the loan portfolio, the Company maintains a Watch List, which includes Classified loans. These loans involve anticipated potential payment defaults or collateral inadequacies. A loan on the Watch List is considered impaired when management believes it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the

collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

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The following table sets forth the recorded investment in nonperforming loans, disaggregated by segment, held by the Company as of June 30, 2012, and December 31, 2011. The recorded investment represents principal balances net of any partial charge-offs. Related accrued interest and net unamortized fees and costs are immaterial and are excluded from the table.

	June 30, 2012	December 31, 2011
Nonaccrual loans:		
Commercial	$205	$800
Real estate:		
Construction, land, and land development	3,356	4,220
1-4 family residential first mortgages	870	923
Home equity	—	—
Commercial	2,519	2,629
Consumer and other loans	—	—
Total nonaccrual loans	6,950	8,572
Loans past due 90 days and still accruing interest:		
Commercial	—	—
Real estate:		
Construction, land, and land development	480	—
1-4 family residential first mortgages	—	—
Home equity	—	—
Commercial	—	—
Consumer and other loans	—	—
Total loans past due 90 days and still accruing interest	480	—
Troubled debt restructured loans[(1)]:		
Commercial	27	—
Real estate:		
Construction, land, and land development	—	1,094
1-4 family residential first mortgages	243	171
Home equity	—	—
Commercial	825	856
Consumer and other loans	—	—
Total troubled debt restructured loans	1,095	2,121
Total nonperforming loans	$8,525	$10,693

(1) While TDR loans are commonly reported by the industry as nonperforming, those not classified in the nonaccrual category are accruing interest due to payment performance. TDR loans on nonaccrual status would be included in the nonaccrual category if there were any, however, there were none at these dates. As of June 30, 2012, loans past due 90 days consisted of one TDR loan.

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The following table shows the pre- and post-modification recorded investment in TDR loans by type of modification and loan segment that have occurred during the three and six months ended June 30, 2012.

	Three Months Ended June 30, 2012			Six months ended June 30, 2012		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Lengthened amortization:						
Commercial	—	$—	$—	1	$28	$28
Real estate:						
Construction, land, and land development	—	—	—	—	—	—
1-4 family residential first mortgages	1	74	74	1	74	74
Home equity	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	—	—
	1	74	74	2	102	102

There was no financial impact for specific reserves or from charge-offs for the modified loans included in the previous table. There were no TDR loans that have been modified within the previous twelve months and have subsequently had a payment default during the three or six months ended June 30, 2012.

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The following tables summarize the recorded investment in impaired loans by segment, broken down by loans with no related allowance and loans with a related allowance and the amount of that allowance as of June 30, 2012, and December 31, 2011, and the average recorded investment and interest income recognized on these loans for the three and six months ended June 30, 2012 and 2011.

	June 30, 2012			December 31, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial	$232	$232	N/A	$800	$800	N/A
Real Estate:						
Construction, land, and land development	3,836	5,302	N/A	—	—	N/A
1-4 family residential	1,113	1,113	N/A	1,094	1,094	N/A
Home equity	—	—	N/A	—	—	N/A
Commercial	3,345	4,538	N/A	3,484	4,678	N/A
Consumer and other	—	—	N/A	—	—	N/A
	8,526	11,185	N/A	5,378	6,572	N/A
With an allowance recorded:						
Commercial	—	—	—	4,577	4,577	100
Real Estate:						
Construction, land, and land development	11,021	11,021	1,500	17,359	17,359	2,630
1-4 family residential	488	488	7	283	283	84
Home equity	—	—	—	156	156	156
Commercial	1,267	1,267	200	1,278	1,278	200
Consumer and other	—	—	—	42	42	12
	12,776	12,776	1,707	23,695	23,695	3,182
Total:						
Commercial	232	232	—	5,377	5,377	100
Real Estate:						
Construction, land, and land development	14,857	16,323	1,500	17,359	17,359	2,630
1-4 family residential	1,601	1,601	7	1,377	1,377	84
Home equity	—	—	—	156	156	156
Commercial	4,612	5,805	200	4,762	5,956	200
Consumer and other	—	—	—	42	42	12
	$21,302	$23,961	$1,707	$29,073	$30,267	$3,182

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	Three Months Ended June 30,				Six Months Ended June 30,			
	2012		2011		2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:								
Commercial	$478	$ 79	$1,451	$ —	$616	$ 79	$1,902	$ —
Real Estate:								
Construction, land, and land development	959	—	136	2	1,754	—	137	3
1-4 family residential	1,123	2	1,133	—	1,110	3	1,032	1
Home equity	—	—	7	—	—	—	17	—
Commercial	3,472	15	3,642	11	3,493	35	4,788	51
Consumer and other	—	—	12	—	—	—	13	1
	6,032	96	6,381	13	6,973	117	7,889	56
With an allowance recorded:								
Commercial	3	—	4,953	73	1,309	24	6,108	138
Real Estate:								
Construction, land, and land development	15,067	141	13,579	177	14,842	302	13,835	350
1-4 family residential	649	8	71	6	488	15	112	6
Home equity	—	—	—	—	45	—	—	—
Commercial	1,269	22	—	—	1,271	46	—	—
Consumer and other	8	—	43	1	21	1	43	1
	16,996	171	18,646	257	17,976	388	20,098	495
Total:								
Commercial	481	79	6,404	73	1,925	103	8,010	138
Real Estate:								
Construction, land, and land development	16,026	141	13,715	179	16,596	302	13,972	353
1-4 family residential	1,772	10	1,204	6	1,598	18	1,144	7
Home equity	—	—	7	—	45	—	17	—
Commercial	4,741	37	3,642	11	4,764	81	4,788	51
Consumer and other	8	—	55	1	21	1	56	2
	$23,028	$ 267	$25,027	$ 270	$24,949	$ 505	$27,987	$ 551

The following table reconciles the balance of nonaccrual loans with impaired loans as of June 30, 2012, and December 31, 2011.

	June 30, 2012	December 31, 2011
Nonaccrual loans	$6,950	$8,572
Troubled debt restructured loans	1,095	2,121
Other impaired loans still accruing interest	13,257	18,380

Total impaired loans	$21,302	$29,073

The balance of impaired loans at June 30, 2012, and December 31, 2011, was comprised of 16 different borrowers. The Company has no commitments to advance additional funds on any of the impaired loans.

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The following tables provide an analysis of the payment status of the recorded investment in loans as of June 30, 2012, and December 31, 2011.

	June 30, 2012						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	90 Days and Still Accruing
Commercial	$46	$—	$—	$46	$260,801	$260,847	$—
Real estate:							
Construction, land, and land development	—	—	3,836	3,836	103,819	107,655	480
1-4 family residential first mortgages	494	—	793	1,287	60,086	61,373	—
Home equity	8	—	—	8	23,345	23,353	—
Commercial	505	—	2,519	3,024	396,670	399,694	—
Consumer and other	—	—	—	—	5,662	5,662	—
Total	$1,053	$—	$7,148	$8,201	$850,383	$858,584	$480
Nonaccrual loans included above	$77	$—	$6,668	$6,745	$205	$6,950	

	December 31, 2011						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	90 Days and Still Accruing
Commercial	$179	$1	$—	$180	$255,522	$255,702	$—
Real estate:							
Construction, land, and land development	4,220	—	—	4,220	97,387	101,607	—
1-4 family residential first mortgages	703	6	809	1,518	61,700	63,218	—
Home equity	47	75	—	122	26,301	26,423	—
Commercial	—	60	2,434	2,494	383,643	386,137	—
Consumer and other	1	—	—	1	6,154	6,155	—
Total	$5,150	$142	$3,243	$8,535	$830,707	$839,242	$—
Nonaccrual loans included above	$4,235	$60	$3,243	$7,538	$1,034	$8,572	

The following tables show the recorded investment in loans by credit quality indicator and loan segment as of June 30, 2012, and December 31, 2011.

	June 30, 2012				
	Pass	Watch	Substandard	Doubtful	Total
Commercial	$239,147	$10,770	$10,930	$—	$260,847
Real estate:					
Construction, land, and land development	88,725	314	18,616	—	107,655
1-4 family residential first mortgages	51,241	8,314	1,818	—	61,373
Home equity	23,086	200	67	—	23,353
Commercial	378,817	6,438	14,439	—	399,694
Consumer and other	5,595	67	—	—	5,662

Total	$786,611	$26,103	$45,870	$—	$858,584

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	December 31, 2011				
	Pass	Watch	Substandard	Doubtful	Total
Commercial	$227,088	$10,458	$18,156	$—	$255,702
Real estate:					
Construction, land, and land development	78,402	2,087	21,118	—	101,607
1-4 family residential first mortgages	60,474	664	2,080	—	63,218
Home equity	25,987	280	156	—	26,423
Commercial	367,094	6,209	12,834	—	386,137
Consumer and other	6,029	72	54	—	6,155
Total	$765,074	$19,770	$54,398	$—	$839,242

All loans are subject to the assessment of a credit quality indicator. Risk ratings are assigned for each loan at the time of approval and change as circumstances dictate during the term of the loan. The Company utilizes a 9-point risk rating scale as shown below, with ratings 1 - 5 included in the Pass column, rating 6 included in the Watch column, ratings 7 - 8 included in the Substandard column, and rating 9 included in the Doubtful column. The Substandard column includes all loans classified as impaired as well as loans with ratings 7 and 8, which are included in the general evaluation of the allowance for loan losses.

Risk rating 1: The loan is secured by cash equivalent collateral.

Risk rating 2: The loan is secured by properly margined marketable securities, bonds, or cash surrender value of life insurance.

Risk rating 3: The borrower is in strong financial condition and has strong debt service capacity. The loan is performing as agreed and the financial characteristics and trends of the borrower exceed industry statistics.

Risk rating 4: The borrower is in satisfactory financial condition and has satisfactory debt service capacity. The loan is performing as agreed and the financial characteristics and trends of the borrower fall in line with industry statistics.

Risk rating 5: The borrower's financial condition is less than satisfactory. The loan is still generally paying as agreed, but strained cash flow may cause some slowness in payments. Collateral values adequately preclude loss. Financial characteristics and trends lag industry statistics. There may be noncompliance with loan covenants.

Risk rating 6: The borrower's financial condition is deficient. Payment delinquencies may be more common. Collateral values still protect from loss, but margins are narrow. Loan may be reliant on secondary sources of repayment, including liquidation of collateral and guarantor support.

Risk rating 7: The loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Well-defined weaknesses exist that jeopardize the liquidation of the debt. The Company is inadequately protected by the valuation or paying capacity of the collateral pledged. If deficiencies are not corrected, there is a distinct possibility that a loss will be sustained.

Risk rating 8: All the characteristics of rating 7 exist with the added condition that the loan is past due more than 90 days or there is reason to believe the Company will not receive its principal and interest according to the terms of the loan agreement.

Risk rating 9: All of the weaknesses inherent in risk ratings 7 and 8 exist with the added condition that collection or liquidation, on the basis of currently known facts, conditions, and values is highly questionable and improbable. A loan reaching this category would most likely be charged off.

Credit quality indicators for all loans and the Company's risk rating process are dynamic and updated on a continuous basis. Risk ratings are updated as circumstances that could affect the repayment of an individual loan are brought to management's attention through an established monitoring process. Individual lenders initiate changes as appropriate for ratings 1 through 5 and changes for ratings 6 through 9 are initiated via communications with management. The likelihood of loss increases as the risk rating increases and is generally preceded by a loan appearing on the Watch List, which consists of all loans with a risk rating of 6 or higher.

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In all portfolio segments, the primary risks are that a borrower's income stream diminishes to the point they are not able to make scheduled principal and interest payments and any collateral securing the loan has declined in value. For commercial loans, including construction and commercial real estate loans, that income stream consists of the operations of the business. For consumer loans, including 1-4 family residential and home equity loans, that income stream typically consists of wages. The risk of declining collateral values is present for most types of loans. For commercial loans, the collateral is generally comprised of accounts receivable, fixed assets, and inventory. Accounts receivable can diminish in value if collections are not timely. Fixed assets tend to depreciate over time and inventory can become obsolete. For all types of loans secured by real estate, it is possible for the value of the real estate to decline.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans in each of the Company's segments are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans, based on an evaluation of the collectibility of loans and prior loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, the review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions or the other factors relied upon.

The allowance for loan losses consists of specific and general components. The specific component relates to loans that meet the definition of impaired. The general component covers the remaining loans and is based on historical loss experience adjusted for qualitative factors such as delinquency trends, loan growth, economic elements, and local market conditions. These same policies are applied to all segments of loans. In addition, regulatory agencies, as an integral part of their examination processes, periodically review West Bank's allowance for loan losses, and may require West Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The following tables detail changes in the allowance for loan losses by segment for the three and six months ended June 30, 2012 and 2011.

	Three Months Ended June 30, 2012						
	Real Estate						
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$3,916	$4,134	$ 1,234	$601	$ 6,697	$69	$16,651
Charge-offs	—	(1,466)	(25)	—	(1)	—	(1,492)
Recoveries	188	—	8	3	—	15	214
Provision [1]	(108)	398	(127)	(8)	(135)	(20)	—
Ending balance	$3,996	$3,066	$ 1,090	$596	$ 6,561	$64	$15,373

	Three Months Ended June 30, 2011						
	Real Estate						
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$6,102	$3,890	$ 629	$717	$ 6,016	$156	$17,510
Charge-offs	(628)	—	—	(40)	(50)	(3)	(721)
Recoveries	528	—	8	7	1	7	551

Provision [1]	24	(138)	298	(20)	307	(21)	450
Ending balance	$6,026	$3,752	$935	$664	$6,274	$139	$17,790

	Six months ended June 30, 2012						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$4,409	$3,572	$1,215	$832	$6,667	$83	$16,778
Charge-offs	—	(1,508)	(64)	(95)	(1)	(12)	(1,680)
Recoveries	235	—	15	8	—	17	275
Provision [1]	(648)	1,002	(76)	(149)	(105)	(24)	—
Ending balance	$3,996	$3,066	$1,090	$596	$6,561	$64	$15,373

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	Six months ended June 30, 2011						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Beginning balance	$7,940	$3,787	$ 647	$658	$ 5,823	$ 232	$19,087
Charge-offs	(2,107)	—	(526)	(40)	(298)	(3)	(2,974)
Recoveries	681	—	24	12	1	9	727
Provision [(1)]	(488)	(35)	790	34	748	(99)	950
Ending balance	$6,026	$3,752	$ 935	$664	$ 6,274	$ 139	$17,790

(1) The negative provisions for the various segments are either related to the decrease in each of those portfolio segments during the time periods disclosed or improvement in the credit quality factors related to those portfolio segments.

The following tables show a breakdown of the allowance for loan losses disaggregated on the basis of impairment analysis method by segment as of June 30, 2012, and December 31, 2011.

	June 30, 2012						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Ending balance:							
Individually evaluated for impairment	$—	$1,500	$ 7	$—	$ 200	$—	$1,707
Collectively evaluated for impairment	3,996	1,566	1,083	596	6,361	64	13,666
Total	$3,996	$3,066	$ 1,090	$596	$ 6,561	$ 64	$15,373

	December 31, 2011						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Ending balance:							
Individually evaluated for impairment	$100	$2,630	$ 84	$156	$ 200	$ 12	$3,182
Collectively evaluated for impairment	4,309	942	1,131	676	6,467	71	13,596
Total	$4,409	$3,572	$ 1,215	$832	$ 6,667	$ 83	$16,778

The following tables show the recorded investment in loans, exclusive of unamortized fees and costs, disaggregated on the basis of impairment analysis method by segment as of June 30, 2012, and December 31, 2011.

June 30, 2012						
	Real Estate					
Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total

Ending balance:							
Individually evaluated for impairment	$232	$14,857	$ 1,601	$—	$ 4,612	$—	$21,302
Collectively evaluated for impairment	260,615	92,798	59,772	23,353	395,082	5,662	837,282
Total	$260,847	$107,655	$ 61,373	$23,353	$ 399,694	$5,662	$858,584

	December 31, 2011						
		Real Estate					
	Commercial	Construction and Land	1-4 Family Residential	Home Equity	Commercial	Consumer and Other	Total
Ending balance:							
Individually evaluated for impairment	$5,377	$17,359	$ 1,377	$156	$ 4,762	$42	$29,073
Collectively evaluated for impairment	250,325	84,248	61,841	26,267	381,375	6,113	810,169
Total	$255,702	$101,607	$ 63,218	$26,423	$ 386,137	$6,155	$839,242

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5. Fair Value Measurements

Accounting guidance on fair value measurements and disclosures defines fair value, establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system, and defines required disclosures. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts business.

The Company's balance sheet contains securities available for sale that are recorded at fair value on a recurring basis. The three-level valuation hierarchy for disclosure of fair value is as follows:

Level 1 uses quoted market prices in active markets for identical assets or liabilities.

Level 2 uses observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 uses unobservable inputs that are not corroborated by market data.

When available, quoted market prices are used to determine the fair value of investment securities and such items are classified within Level 1 of the fair value hierarchy. Examples include U.S. Treasury securities and certain corporate bonds. For other securities, the Company determines fair value based on various sources and may apply matrix pricing with observable prices for similar bonds where a price for the identical bond is not observable. Securities measured at fair value by such methods are classified as Level 2. The fair values of Level 2 securities are determined by pricing models that consider observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers, and live trading systems. Certain securities are not valued based on observable inputs and are, therefore, classified as Level 3. The fair value of these securities is based on management's best estimates. The Company's policy is to recognize transfers between levels at the end of each reporting period, if applicable.

Generally, management obtains the fair value of investment securities at the end of each reporting period via a third party pricing service. Management, with the assistance of an independent investment advisory firm, reviewed the valuation process used by the third party and believes that process is valid. On a quarterly basis management corroborates the fair values of investment securities by obtaining pricing from an independent investment advisory firm and compares the two sets of fair values. Any significant variances are reviewed and investigated. In addition, the Company has instituted a practice of further testing the fair values of a sample of securities. For that sample, the prices are further validated by management, with assistance from an independent investment advisory firm, by obtaining details of the inputs used by the pricing service. Those inputs were independently tested, and we concluded the fair values were consistent with GAAP requirements and securities were properly classified in the fair value hierarchy.

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The following tables present the balances of assets measured at fair value on a recurring basis by level as of June 30, 2012, and December 31, 2011.

	June 30, 2012			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. government agencies and corporations	$18,033	$—	$18,033	$—
State and political subdivisions	56,753	—	56,753	—
Collateralized mortgage obligations	197,751	—	197,751	—
Mortgage-backed securities	42,825	—	42,825	—
Trust preferred securities	1,898	—	761	1,137
Corporate notes and other investments	698	—	698	—
Total	$317,958	$—	$316,821	$1,137

	December 31, 2011			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. government agencies and corporations	$13,003	$—	$13,003	$—
State and political subdivisions	52,517	—	52,517	—
Collateralized mortgage obligations	175,498	—	175,498	—
Mortgage-backed securities	35,636	—	35,636	—
Trust preferred securities	2,011	—	766	1,245
Corporate notes and other investments	4,480	3,708	772	—
Total	$283,145	$3,708	$278,192	$1,245

There were no transfers between Levels of the fair value hierarchy during the six months ended June 30, 2012.

The following table presents changes in securities available for sale with significant unobservable inputs (Level 3) for the three and six months ended June 30, 2012 and 2011.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Beginning balance	$1,189	$1,427	$1,245	$1,339
Transfer into level 3	—	—	—	—
Total gains or (losses):				
Included in earnings	(127)	—	(173)	—
Included in other comprehensive income	75	155	65	243
Sale of security	—	—	—	—
Principal payments	—	—	—	—
Ending balance	$1,137	$1,582	$1,137	$1,582

The ending balances in the previous table consist of one pooled TPS.

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Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following tables present those assets carried on the balance sheet by caption and by level within the valuation hierarchy as of June 30, 2012, and December 31, 2011.

	June 30, 2012			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans	$11,069	$—	$—	$11,069
Other real estate owned	9,241	—	—	9,241
Total	$20,310	$—	$—	$20,310

	December 31, 2011			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans	$20,513	$—	$—	$20,513
Other real estate owned	10,967	—	—	10,967
Total	$31,480	$—	$—	$31,480

Loans in the tables above consist of impaired loans for which a fair value adjustment has been recorded. Impaired loans are evaluated and valued at the lower of cost or fair value when the loan is identified as impaired. Fair value is measured based on the value of the collateral securing these loans and is classified as Level 3 in the fair value hierarchy. Collateral may be real estate or business assets such as equipment, inventory, or accounts receivable. Fair value is determined by appraisals. Appraised or reported values may be discounted based on management's opinions concerning market developments or the client's business. Other real estate owned in the tables above consist of property acquired through foreclosures and settlements of loans. Property acquired is carried at fair value of the property, less estimated disposal costs, and is classified as Level 3 in the fair value hierarchy.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

Cash and due from banks: The carrying amount approximates fair value.

Federal funds sold and other short-term investments: The carrying amount approximates fair value.

Federal Home Loan Bank stock: The fair value of this restricted stock is estimated at its carrying value and redemption price of $100 per share.

Loans held for sale: The fair values of loans held for sale are based on estimated selling prices.

Loans: The fair values of loans are estimated using discounted cash flow analysis based on observable market interest rates currently being offered for loans with similar terms to borrowers with similar credit quality.

Deposits: The carrying amounts for demand and savings deposits, which represent the amounts payable on demand, approximate their fair values. The fair values for fixed-rate and variable-rate certificates of deposit are estimated using discounted cash flow analysis, based on observable market interest rates currently being offered on certificates with similar terms.

Accrued interest receivable and payable: The fair values of both accrued interest receivable and payable approximate their carrying amounts.

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Short-term and other borrowings: The carrying amounts of federal funds purchased and securities sold under agreements to repurchase approximate their fair values. The fair values of FHLB advances and subordinated notes are estimated using discounted cash flow analysis, based on observable market interest rates currently being offered with similar terms.

Commitments to extend credit and standby letters of credit: The approximate fair values of commitments and standby letters of credit are based on the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and creditworthiness of the counterparties.

The following table includes the carrying amounts and approximate fair values of financial assets and liabilities as of June 30, 2012, and December 31, 2011.

		June 30, 2012		December 31, 2011	
	Fair Value Hierarchy Level	Carrying Amount	Approximate Fair Value	Carrying Amount	Approximate Fair Value
Financial assets:					
Cash and due from banks	Level 1	$36,555	$36,555	$35,772	$35,772
Federal funds sold and other short-term investments	Level 1	76,303	76,303	51,332	51,332
Securities available for sale	See previous table	317,958	317,958	283,145	283,145
Federal Home Loan Bank stock	Level 1	11,639	11,639	11,352	11,352
Loans held for sale	Level 2	3,777	3,829	4,089	4,139
Loans, net	Level 2	843,041	856,573	822,181	829,675
Accrued interest receivable	Level 1	4,566	4,566	4,183	4,183
Financial liabilities:					
Deposits	Level 2	1,027,134	1,029,263	957,373	960,607
Federal funds purchased and securities sold under agreements to repurchase	Level 1	60,711	60,711	55,841	55,841
Accrued interest payable	Level 1	553	553	734	734
Subordinated notes	Level 2	20,619	11,769	20,619	11,029
Federal Home Loan Bank advances	Level 2	105,000	116,437	105,000	116,006
Off-balance-sheet financial instruments:					
Commitments to extend credit	Level 3	—	—	—	—
Standby letters of credit	Level 3	—	—	—	—

6. Stock Compensation Plans

At the Company's annual meeting of shareholders on April 26, 2012, the West Bancorporation, Inc. 2012 Equity Incentive Plan (the 2012 Plan) was approved by the shareholders, replacing the West Bancorporation, Inc. Restricted Stock Compensation Plan, which had no awards outstanding. The 2012 Plan is administered by the Compensation Committee of the Board of Directors. All employees and directors of and service providers to the Company and its subsidiary are eligible to become participants in the 2012 Plan, except that non-employees may not be granted incentive stock options. Under the terms of the 2012 Plan, the Company may grant a total of 800,000 shares of the Company's common stock as non-qualified and incentive stock options, stock appreciation rights (SARS), stock awards, and cash incentive awards. The Compensation Committee will determine the specific individuals who will be granted awards under the 2012 Plan and the type and amount of any such awards.

Under the 2012 Plan, the Company may grant restricted stock unit (RSU) awards, as determined by the Compensation Committee, that vest upon the completion of future service requirements or specified performance criteria. On May

17, 2012, there were 21,706 RSUs granted to certain executive officers and other employees. These RSUs were granted at no cost to the participants and the participants will not be entitled to dividends until the RSUs have vested. Each RSU entitles the participant to receive one share of common stock on the vesting date, which is two years after the grant date or upon the participant's termination due to death or disability, or upon a change in control of the Company if the RSUs are not fully assumed or if the RSUs are assumed and the participant's employment is terminated without cause for good reason. If a participant terminates employment prior to the end of the continuous service period other than due to death, disability, or retirement, the award is forfeited. If a participant terminates service due to retirement, the RSUs will continue to vest, subject to provisions of the 2012 Plan.

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The following is a summary of nonvested RSU activity for the three and six months ended June 30, 2012:

	Three and Six Months Ended June 30, 2012	
	Shares	Weighted-Average Grant-Date Fair Value Per Share
Nonvested shares, beginning of period	—	
Granted	21,706	$9.11
Vested	—	—
Forfeited	—	—
Nonvested shares, end of period	21,706	

The Company recognizes compensation expense for stock-based awards based on the fair value of the award at the grant date and based upon the number of awards ultimately expected to vest. The fair value of nonvested RSUs granted is equal to the fair market value of the underlying common stock at the grant date. Compensation expense is recognized on the straight-line method over the vesting period. The Company currently assumes no projected forfeitures on its stock-based compensation, since all RSUs are expected to vest.

Total compensation costs recorded for the RSUs were $15 for the three and six months ended June 30, 2012. As of June 30, 2012, there was $166 of unrecognized compensation costs related to nonvested RSUs, and the weighted average period over which these remaining costs are expected to be recognized is approximately 1.8 years.

7. Earnings per Common Share

Basic earnings per common share are computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Income available to common stockholders is net income less preferred stock dividends and accretion of discount on preferred stock, which is treated as preferred stock dividends. The remaining unaccreted discount on preferred stock was recognized at June 29, 2011, when all of the Company's outstanding preferred stock was redeemed. The Company has 50,000,000 authorized shares of $0.01 par value preferred stock, with no shares issued or outstanding as of June 30, 2012, and December 31, 2011. The related outstanding common stock warrant was repurchased on August 31, 2011, for $700. Diluted earnings per common share for the three and six months ended June 30, 2011, reflect the potential dilution that could occur if the Company's previously outstanding stock warrant was exercised and converted into common stock. Diluted earnings per common share for all periods reflect the potential dilution that could occur if the Company's outstanding RSUs were vested. The dilutive effect was computed using the treasury stock method, which assumes all outstanding warrants were exercised and assumes all stock-based awards are exercised and the hypothetical proceeds from exercise are used by the Company to purchase common stock at the average market price during the period. The incremental shares, to the extent they would have been dilutive, are included in the denominator of the diluted earnings per common share calculation. The calculation of earnings per common share and diluted earnings per common share for the three and six months ended June 30, 2012 and 2011, is presented in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share information)	2012	2011	2012	2011
Net income	$4,383	$3,923	$8,360	$8,453
Preferred stock dividends	—	(445)	—	(895)
Preferred stock discount accretion	—	(1,371)	—	(1,492)
Net income available to common stockholders	$4,383	$2,107	$8,360	$6,066
Weighted average common shares outstanding	17,404	17,404	17,404	17,404
Restricted stock units	11	—	16	—
Common stock warrant [1]	—	—	—	—
	17,415	17,404	17,420	17,404

Diluted weighted average common shares outstanding				
Basic earnings per common share	$0.25	$0.12	$0.48	$0.35
Diluted earnings per common share	$0.25	$0.12	$0.48	$0.35

(1) The average closing price of the Company's common stock for the three and six months ended June 30, 2011, was $7.60 and $7.56, respectively. These average closing prices were less than the $11.39 exercise price of the common stock warrant to purchase 474,100 shares of common stock; therefore, the warrant was not dilutive during the period it was outstanding.

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8. Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists of the net change in unrealized gains and losses on the Company's securities available for sale, including the noncredit-related portion of unrealized losses of OTTI securities.

The following tables summarize the changes in the balances of each component of accumulated other comprehensive income (loss) for the six months ended June 30, 2012 and 2011.

	Noncredit-related Unrealized (Losses) on Securities with OTTI	Unrealized Gains (Losses) on Securities without OTTI	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2011	$(1,940)	$2,594	$654
Current period other comprehensive income	40	950	990
Balance, June 30, 2012	$(1,900)	$3,544	$1,644
Balance, December 31, 2010	$(1,943)	$(704)	$(2,647)
Current period other comprehensive income	151	2,915	3,066
Balance, June 30, 2011	$(1,792)	$2,211	$419

The following tables show the tax effects allocated to each component of other comprehensive income for the three and six months ended June 30, 2012 and 2011.

	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Unrealized noncredit-related gains (losses) on securities with OTTI:						
Unrealized holding losses arising during period	$(52)	$20	$(32)	$(108)	$41	$(67)
Less: reclassification adjustment for net losses realized in net income	127	(49)	78	173	(66)	107
Net unrealized holding gains for securities with other than temporary impairment	75	(29)	46	65	(25)	40
Unrealized gains on securities without OTTI:						
Unrealized holding gains arising during the period	1,426	(542)	884	1,778	(676)	1,102
Less: reclassification adjustment for net gains realized in net income	(279)	107	(172)	(246)	94	(152)
Net unrealized gains on securities without OTTI	1,147	(435)	712	1,532	(582)	950
Other comprehensive income	$1,222	$(464)	$758	$1,597	$(607)	$990

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	Three Months Ended June 30, 2011			Six Months Ended June 30, 2011		
	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Unrealized noncredit-related gains on securities with OTTI:						
Unrealized holding gains arising during period	$155	$(58)	$97	$243	$(92)	$151
Less: reclassification adjustment for net losses realized in net income	—	—	—	—	—	—
Net unrealized holding gains for securities with other than temporary impairment	155	(58)	97	243	(92)	151
Unrealized gains on securities without OTTI:						
Unrealized holding gains arising during period	3,413	(1,297)	2,116	4,702	(1,787)	2,915
Less: reclassification adjustment for net losses realized in net income	—	—	—	—	—	—
Net unrealized gains on securities without OTTI	3,413	(1,297)	2,116	4,702	(1,787)	2,915
Other comprehensive income	$3,568	$(1,355)	$2,213	$4,945	$(1,879)	$3,066

9. Deferred Income Taxes

Tax effects of temporary differences that give rise to net deferred tax assets consist of the following as of June 30, 2012, and December 31, 2011.

	June 30, 2012	December 31, 2011
Allowance for loan losses	$5,841	$6,376
Intangibles	1,850	2,004
Investment security impairment	95	35
Other real estate owned	1,391	1,472
Accrued expenses	516	526
State net operating loss carryforward	485	442
Capital loss carryforward	4,125	4,125
Net deferred loan fees and costs	(262)	(252)
Net unrealized gains on securities available for sale	(1,008)	(401)
Premises and equipment	(579)	(590)
Loans	(798)	(718)
Other	(76)	(8)
Net deferred tax assets before valuation allowance	11,580	13,011
Valuation allowance	(4,705)	(4,602)
Net deferred tax assets	$6,875	$8,409

The Company has recorded a valuation allowance against the tax effect of the state net operating loss carryforwards, federal and state capital loss carryforwards, and investment security impairment as management believes it is more likely than not that such carryforwards will expire without being utilized.

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10. Commitments and Contingencies

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations that it uses for on-balance-sheet instruments. The Company's commitments as of June 30, 2012, and December 31, 2011, consisted of the following approximate amounts.

	June 30, 2012	December 31, 2011
Commitments to extend credit	$280,612	$255,167
Standby letters of credit	9,393	9,923
	$290,005	$265,090

West Bank has executed Mortgage Partnership Finance (MPF) Master Commitments (the Commitments) with the FHLB of Des Moines to deliver mortgage loans and to guarantee the payment of any realized losses that exceed the FHLB's first loss account for mortgages delivered under the Commitments. West Bank receives credit enhancement fees from the FHLB for providing this guarantee and continuing to assist with managing the credit risk of the MPF Program mortgage loans. The term of the current Commitment is through February 28, 2013. At June 30, 2012, the liability represented by the present value of the credit enhancement fees less any expected losses in the mortgages delivered under the Commitments was approximately $404.

On September 29, 2010, West Bank was sued in a purported class action lawsuit that, as amended, contains allegations that nonsufficient funds fees charged by West Bank to Iowa resident noncommercial customers on bank card transactions were impermissible finance charges under the Iowa Consumer Credit Code, rather than allowable fees, and that the sequence in which West Bank formerly posted items for payment violated its duties of good faith under the Iowa Uniform Commercial Code and Consumer Credit Code. West Bank believes the allegations in the lawsuit are factually and legally inaccurate. West Bank is vigorously defending this litigation. The amount of potential loss, if any, cannot be reasonably estimated now because there are substantial and different defenses concerning the various claims of potential liability and class certification. Even if legal liability is established under some theory, which West Bank believes would be improper under existing Iowa law, the amount of each plaintiff's damage claim would likely require individual determination due to the potential applicability of different offsets or credits.

In the normal course of business, the Company and West Bank are involved in various other legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

"SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are “forward-looking statements” within the meanings of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report. These forward-looking statements are generally identified by the words “believes,” “expects,” “intends,” “should,” “anticipates,” “projects,” “future,” “may,” “should,” “will,” “plan,” “opportunity,” “will be,” “will likely result,” “will continue,” or similar references, or references to estimates,

predictions, or future events. Such forward-looking statements are based upon certain underlying assumptions, risks, and uncertainties. Because of the possibility that the underlying assumptions are incorrect or do not materialize as expected in the future, actual results could differ materially from these forward-looking statements. Risks and uncertainties that may affect future results include: interest rate risk; competitive pressures; pricing pressures on loans and deposits; changes in credit and other risks posed by the Company's loan and investment portfolios, including declines in commercial or residential real estate values or changes in the allowance for loan losses dictated by new market conditions or regulatory requirements; actions of bank and non-bank competitors; changes in local and national economic conditions; changes in regulatory requirements, limitations, and costs; changes in customers' acceptance of the Company's products and services; and any other risks described in the “Risk Factors” sections of this and other reports made by the Company. The Company undertakes no obligation to revise or update such forward-looking statements to reflect current or future events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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THREE AND SIX MONTHS ENDED JUNE 30, 2012
(in thousands, except per share amounts)

OVERVIEW

The following discussion describes the consolidated operations of the Company, including West Bank, West Bank's wholly-owned subsidiary WB Funding Corporation (which owns an interest in SmartyPig, LLC), West Bank's 99.99 percent owned subsidiary ICD IV, LLC (a community development entity), and the Company's consolidated financial condition as of the end of the second quarter 2012. Results of operations for the three and six months ended June 30, 2012, are compared to the results for the same periods in 2011, and the consolidated financial condition of the Company as of June 30, 2012, is compared to balances as of December 31, 2011.

Net income available to common stockholders for the second quarter of 2012 was $4,383 compared to $2,107 for the second quarter of 2011. The most significant difference from last year was the preferred stock dividends and accretion of discount totaling $1,816. The Company's outstanding preferred stock was redeemed on June 29, 2011, so there were no such dividends and accretion of discount in 2012. Net income for the second quarter of 2011 before such dividends and accretion of discount was $3,923.

Total basic and diluted earnings per common share were $0.25 and $0.12 for the second quarters of 2012 and 2011, respectively. The Company's annualized returns on average equity and average assets for the quarter ended June 30, 2012, were 13.69 and 1.32 percent, respectively, compared to 10.36 and 1.21 percent, respectively, for the quarter ended June 30, 2011.

Net interest income for the second quarter held steady when compared to the same time period in 2011, despite continued downward pressure on interest rates. As a result of continued credit quality improvement, there was no provision for loan losses recorded in the second quarter of 2012 compared to $450 in the same quarter of 2011. Compared to a year ago, nonperforming assets declined 18.6 percent. As of June 30, 2012, the allowance for loan losses was 1.79 percent of loans outstanding and was deemed by management to be adequate to absorb any losses inherent in the loan portfolio.

Noninterest income increased $1,230 compared to the second quarter of 2011 primarily due to increased gains and fees on sales of residential mortgages of $309 and realized net investment securities gains of $279. In addition, a gain of $841 from bank-owned life insurance was recognized due to the death of a long-time West Bank officer. Noninterest expense was $1,437 higher in the second quarter of 2012 than in 2011 due to a $401 increase in salaries and employee benefit costs and write-downs of $745 on other real estate owned properties.

Net income available to common stockholders for the six months ended June 30, 2012, was $8,360 compared to $6,066 for the six months ended June 30, 2011. Like the second quarter, results for the first six months of 2011 were impacted by preferred stock dividends and accretion of discount. Net income for the first six months of 2012 declined $93 from $8,453 for the same period in 2011. Total basic and diluted earnings per common share were $0.48 and $0.35 for the first six months of 2012 and 2011, respectively. The Company's annualized return on average equity and return on average assets for the six months ended June 30, 2012, were 13.26 and 1.28 percent, respectively, compared to 11.40 and 1.30 percent, respectively, for the six months ended June 30, 2011.

For the six months ended June 30, 2012, net interest income declined $321 from the prior year, primarily due to continued downward pressure on interest rates. No provision for loan losses was recorded compared to $950 in the six months ended June 30, 2011, as a result of continued credit quality improvement in 2012. Other significant changes between the first six months of 2012 and the same time period in 2011 were the $872 increase in gains and fees on sales of residential mortgages, which was offset by a $982 increase in salaries and benefits and a $708 increase in

other real estate owned expenses. In addition, FDIC insurance expense declined by $562 during the same time period.

During the first six months of 2012, total loans outstanding increased $19,455 and increased $9,373 during the second quarter. Management believes the loan portfolio will continue to grow, although at a rather subdued rate. While management would like to see stronger loan growth, the uncertainty surrounding various aspects of the economy is causing many financially stable customers to wait for more clarity before borrowing additional funds to expand their business or purchase assets.

The Board of Directors declared a quarterly dividend of $0.10 per common share at its meeting on July 25, 2012. This amount represents a 25 percent increase over the previous quarterly dividend. The dividend is payable on August 28, 2012, to shareholders of record as of August 8, 2012.

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RESULTS OF OPERATIONS

The following table shows selected financial results and measures for the three and six months ended June 30, 2012, compared with the same periods in 2011.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012	2011	Change	Change %	2012	2011	Change	Change %
Net income	$4,383	$3,923	$460	11.7 %	$8,360	$8,453	$(93)	(1.1)%
Net income available to common shareholders	4,383	2,107	2,276	108.0 %	8,360	6,066	2,294	37.8 %
Average assets	1,339,703	1,303,782	35,921	2.8 %	1,318,207	1,312,649	5,558	0.4 %
Average stockholders' equity	128,757	151,849	(23,092)	(15.2)%	126,779	149,563	(22,784)	(15.2)%
Return on average assets	1.32 %	1.21 %	0.11 %		1.28 %	1.30 %	(0.02)%	
Return on average equity	13.69 %	10.36 %	3.33 %		13.26 %	11.40 %	1.86 %	
Efficiency ratio	49.31 %	48.33 %	0.98 %		50.52 %	47.20 %	3.32 %	
Dividend payout ratio	31.78 %	41.29 %	(9.51)%		33.30 %	14.34 %	18.96 %	
Average equity to average assets ratio	9.61 %	11.65 %	(2.04)%		9.62 %	11.39 %	(1.77)%	

	As of June 30,		
	2012	2011	Change
Texas ratio	13.00 %	16.94 %	(3.94)%
Equity to assets ratio	9.63 %	9.45 %	0.18 %
Tangible common equity ratio	9.63 %	9.45 %	0.18 %

Definitions of ratios:

- Return on average assets - annualized net income divided by average assets.
- Return on average equity - annualized net income divided by average stockholders' equity.
- Efficiency ratio - noninterest expense (excluding other real estate owned expense) divided by noninterest income (excluding net securities gains and net impairment losses) plus tax-equivalent net interest income.
- Dividend payout ratio - dividends paid to common stockholders divided by net income available to common stockholders.
- Texas ratio - total nonperforming assets divided by tangible common equity plus the allowance for loan losses.
- Equity to assets ratio - equity divided by assets.
- Tangible common equity ratio - common equity less intangible assets divided by tangible assets.

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Net Interest Income

The following tables show average balances and related interest income or interest expense, with the resulting average yield or rate by category of interest-earning assets or interest-bearing liabilities. Interest income and the resulting net interest income are shown on a fully taxable basis.
Data for the three months ended June 30:

	Average Balance				Interest Income/Expense				Yield/Rate		
	2012	2011	Change	Change-%	2012	2011	Change	Change-%	2012	2011	Change
Interest-earning assets:											
Loans:											
Commercial	$262,394	$259,248	$3,146	1.21 %	$3,308	$3,296	$12	0.36 %	5.07%	5.10%	(0.03)%
Real estate	590,606	575,686	14,920	2.59 %	7,999	8,415	(416)	(4.94)%	5.45%	5.86%	(0.41)%
Consumer and other	5,854	7,654	(1,800)	(23.52)%	65	110	(45)	(40.91)%	4.47%	5.76%	(1.29)%
Total loans	858,854	842,588	16,266	1.93 %	11,372	11,821	(449)	(3.80)%	5.33%	5.63%	(0.30)%
Investment securities:											
Taxable	271,721	215,718	56,003	25.96 %	1,129	1,126	3	0.27 %	1.66%	2.09%	(0.43)%
Tax-exempt	54,382	54,619	(237)	(0.43)%	765	854	(89)	(10.42)%	5.63%	6.25%	(0.62)%
Total investment securities	326,103	270,337	55,766	20.63 %	1,894	1,980	(86)	(4.34)%	2.32%	2.93%	(0.61)%
Federal funds sold and short-term investments	79,555	105,545	(25,990)	(24.62)%	51	66	(15)	(22.73)%	0.26%	0.25%	0.01 %
Total interest-earning assets	$1,264,512	$1,218,470	$46,042	3.78 %	13,317	13,867	(550)	(3.97)%	4.24%	4.56%	(0.32)%
Interest-bearing liabilities:											
Deposits:											