Support.com, Inc.
Form 10-Q
August 06, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2010

OR

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

For the transition period from to

Commission File No. 000-30901

SUPPORT.COM, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3282005**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

1900 Seaport Boulevard, 3rd Floor

Redwood City, CA 94063

(Address of Principal Executive Offices)

(Zip Code)

Registrant s Telephone Number, Including Area Code: (650) 556-9440

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

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

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

Large accelerated filer	¨	Accelerated filer	x
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 x

On July 31, 2010, 46,870,845 shares of the Registrant s Common Stock, $0.0001 par value, were outstanding.

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SUPPORT.COM, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED JUNE 30, 2010

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUPPORT.COM, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2010 (Unaudited)	December 31, 2009 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,486	$ 23,547
Short-term investments	43,524	56,488
Auction-rate securities put option		1,289
Accounts receivable, net	3,328	3,190
Prepaid expenses and other current assets	2,174	1,252
Total current assets	81,512	85,766
Long-term investments	2,954	3,444
Property and equipment, net	472	447
Goodwill	10,181	10,171
Purchased technology, net	268	309
Intangible assets, net	1,259	1,450
Other assets	523	372
Total assets	$ 97,169	$ 101,959
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,126	$ 99
Accrued compensation	2,291	745
Other accrued liabilities	3,863	3,045
Deferred revenue	950	726
Total current liabilities	8,230	4,615
Other long-term liabilities	842	992
Total Liabilities	9,072	5,607
Stockholders equity:		
Common stock	5	5
Additional paid-in capital	224,075	221,822
Accumulated other comprehensive loss	(1,348)	(1,233)
Accumulated deficit	(134,635)	(124,242)
Total stockholders equity	88,097	96,352
Total liabilities and stockholders equity	$ 97,169	$ 101,959

(1) Derived from the December 31, 2009 audited Consolidated Financial Statements included in the Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (SEC) on March 12, 2010.

See accompanying notes.

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SUPPORT.COM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenue:				
Services	$ 6,882	$ 3,374	$ 13,612	$ 6,926
Software and other	3,004	59	6,133	121
Total revenue	9,886	3,433	19,745	7,047
Cost of revenue:				
Cost of services	7,346	4,283	12,830	8,656
Cost of software and other	335		683	
Total cost of revenue	7,681	4,283	13,513	8,656
Gross profit (loss)	2,205	(850)	6,232	(1,609)
Operating expenses:				
Research and development	1,281	1,605	2,624	3,303
Sales and marketing	4,320	2,007	8,291	4,058
General and administrative	2,887	2,980	5,839	6,578
Amortization of intangible assets	93	42	181	84
Total operating expenses	8,581	6,634	16,935	14,023
Loss from operations	(6,376)	(7,484)	(10,703)	(15,632)
Interest income and other, net	149	422	335	120
Loss from continuing operations, before income taxes	(6,227)	(7,062)	(10,368)	(15,512)
Income tax provision (benefit)	10	(2,841)	22	(2,837)
Loss from continuing operations, after income taxes	(6,237)	(4,221)	(10,390)	(12,675)
Income (loss) from discontinued operations, after income taxes	2	6,460	(3)	7,518
Net income (loss)	$ (6,235)	$ 2,239	$ (10,393)	$ (5,157)
Earnings (loss) per share:				
Basic and diluted earnings per share				
Loss from continuing operations	$ (0.13)	$ (0.09)	$ (0.22)	$ (0.27)
Income (loss) from discontinued operations	0.00	0.14	(0.00)	0.16
Net earnings (loss) per share	$ (0.13)	$ 0.05	$ (0.22)	$ (0.11)
Shares used in computing per share amounts:				
Basic	46,534	46,360	46,503	46,345

Diluted	46,534	46,360	46,503	46,345

See accompanying notes.

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SUPPORT.COM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2010	2009
Operating Activities:		
Net loss	$ (10,393)	$ (5,157)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Gain on the sale of discontinued operations, net of tax		(4,740)
Depreciation	157	387
Write-off of fixed assets		104
Realized gain on investments	(10)	
Amortization of premiums and discounts on investments	434	(31)
Amortization of purchased technology	41	132
Amortization of intangible assets	181	84
Realized loss on put option re-valuation	1,289	3,724
Realized gain on auction-rate securities	(1,289)	(3,724)
Stock-based compensation	1,888	2,158
Changes in assets and liabilities:		
Accounts receivable, net	(138)	3,035
Prepaid expenses and other current assets	(928)	(52)
Other long-term assets	(172)	(112)
Accounts payable	1,024	(737)
Accrued compensation	1,540	(488)
Other accrued liabilities	799	(6,811)
Other long-term liabilities	(89)	179
Deferred revenue	224	(1,466)
Net cash used in operating activities	(5,442)	(13,515)
Investing Activities:		
Proceeds from sale of discontinued operations		20,475
Purchases of property and equipment	(181)	(66)
Purchases of investments	(24,318)	(13,392)
Sales of investments	17,473	
Maturities of investments	21,054	7,900
Net cash provided by investing activities	14,028	14,917
Financing Activities:		
Proceeds from issuances of common stock	365	265
Net cash provided by financing activities	365	265
Effect of exchange rate changes on cash and cash equivalents	(12)	26
Net increase in cash and cash equivalents	8,939	1,693
Cash and cash equivalents at beginning of period	23,547	64,306

Cash and cash equivalents at end of period	$ 32,486	$ 65,999
Supplemental schedule of cash flow information:		
Income taxes paid	$ 61	$ 130

See accompanying notes.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Support.com, Inc. (the Company or Support.com) and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated. The balance sheet as of June 30, 2010 and the statements of operations for the three and six months ended June 30, 2010 and 2009 and cash flows for the six months ended June 30, 2010 and 2009 are unaudited. In the opinion of management, these unaudited interim condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) that are necessary for a fair presentation of the results for, and as of, the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The condensed consolidated balance sheet information as of December 31, 2009 is derived from audited financial statements as of that date. These unaudited interim condensed consolidated financial statements should be read with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 12, 2010.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. The accounting estimates that require management s most significant and subjective judgments include accounting for revenue recognition, fair value measurements, fair value estimates auction-rate securities (ARS) put option, business combinations purchase accounting, accounting for goodwill and other intangible assets, stock-based compensation and accounting for income taxes. Actual results could differ materially from these estimates.

Reclassifications

Certain amounts in the condensed consolidated financial statements and accompanying notes for the prior period have been reclassified to conform to the current periods presentation. On December 7, 2009 we acquired substantially all of the assets of Xeriton, Inc. and began to report software, and other revenues and cost of revenues on our condensed consolidated financial statements. Following this change in presentation, certain royalty revenues previously reported in the services line have been reclassified to software and other. Net operating results have not been affected by these reclassifications.

Subsequent Events Evaluation

In accordance with Accounting Standard Codification (ASC) 855 (formerly, Financial Standards Accounting Board, FASB 165, Subsequent Events), management has reviewed and evaluated material subsequent events through the filing date of the Company s Form 10Q for the period ended June 30, 2010. All appropriate subsequent event disclosures, if any, have been made in the notes to our condensed consolidated financial statements.

Revenue Recognition

For all transactions, we recognize revenue only when all of the following criteria are met:

- Persuasive evidence of an arrangement exists;

Delivery has occurred;

Collection is considered probable; and

The fees are fixed or determinable.

We consider all arrangements with payment terms longer than 90 days not to be fixed or determinable. If the fee is considered not to be fixed or determinable, revenue is recognized as payment becomes due from the customer.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Services Revenue

Services revenues are comprised primarily of fees for technology support services, including the set-up, protection, optimization and repair of new and existing computers as well as peripheral devices. We provide these services remotely, using work-from-home Personal Technology Experts who utilize our proprietary technology to deliver the services.

We provide services to consumers and small businesses, either through our channel partners (which include brick and mortar and online retailers, anti-virus providers, PC/consumer electronics (PC/CE) manufacturers, internet service providers (ISP s), and others) or directly via our website (www.support.com). We transact with customers via reseller programs, referral programs and direct transactions. In reseller programs, the channel partner generally executes the financial transactions with the consumer and pays a fee to us which we recognize as revenue when the service is provided. In referral programs, we transact with the consumer directly and pay a referral fee to the referring party. In such instances, since we are the transacting party and bear substantially all risks associated with the transaction, we record the gross amount of revenue. In direct-to-consumer transactions, we sell directly to the consumer at the retail price.

Our services are of three types for revenue recognition purposes:

Incident-Based Services Customers purchase a discrete, one-time service. Revenue recognition occurs at the time of service delivery. Fees paid for services sold but not yet delivered are recorded as deferred revenue and recognized at the time of service delivery.

Subscriptions Customers purchase subscriptions or service plans under which certain services are provided over a fixed subscription period. Revenues for subscriptions are recognized ratably using the daily convention over the respective subscription periods.

Service Cards / Gift Cards Customers purchase a service card and/or a gift card, which entitles the cardholder to redeem a certain service at a time of their choosing. For these sales, revenue is deferred until the card has been redeemed and the service has been provided.

For certain direct and channel partnerships, we are paid for services that are sold but not yet delivered. We initially record such balances as deferred revenue, and recognize revenue when the service has been provided or, on the non-subscription portion of these balances, when the likelihood of the service being redeemed by the customer is remote (services breakage). Based upon our historical redemption patterns for these relationships, we believe that the likelihood of a service being delivered more than 90 days after sale is remote. We therefore recognize non-subscription deferred revenue balances older than 90 days as services revenue.

Channel partners are generally invoiced monthly. Fees from consumers via referral programs and direct transactions are generally paid with a credit card at the time of sale. Revenue is recognized net of any applicable sales tax.

We generally provide a refund period on services, during which refunds may be granted to consumers under certain circumstances, including inability to resolve certain support issues. For our channel sales, the refund period varies by partner, but is generally between 5 and 10 days. For referral programs and direct transactions, the refund period is generally 5 days. For all channels, we recognize revenue net of refunds and cancellations during the period. Refunds and cancellations have not been material.

Software and Other Revenue

Software and other revenue is comprised primarily of fees for software products provided through direct consumer downloads and, to a lesser extent, through the sale of this software via channel partners. Our software is sold to consumers as a perpetual license. We act as the primary obligor and generally control fulfillment, pricing, product requirements, and collection risk and therefore we recognize revenues using the gross method. We provide a limited amount of free technical support assistance to customers. We do not defer the recognition of any revenue associated with sales of these products, since the cost of providing this free technical support is insignificant. The technical support is generally provided within one year after the associated revenue is recognized and free product enhancements are minimal and infrequent. Other revenue consists primarily of revenue generated through partners advertising to our customer base in various forms, including toolbar advertising, email marketing, and free trial offers. We recognize other revenue as it is earned.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, Cash Equivalents and Investments

All liquid instruments with an original maturity at the date of purchase of ninety days or less are classified as cash equivalents. Cash equivalents and short-term investments consist primarily of money market funds, commercial paper, corporate and municipal bonds and auction-rate securities (ARS) held by UBS, which have a put option exercisable within one year. On June 30, 2010, we exercised our rights under the Rights Agreement with UBS and settled the ARS for cash on June 30 and July 1, 2010. Long-term investments consist of other ARS positions not held with UBS. Other than the ARS held by UBS, our cash equivalents and short-term investments are classified as available-for-sale, and are reported at fair value with unrealized gains(losses) (when deemed to be temporary) included in accumulated other comprehensive income within stockholders equity on the condensed consolidated balance sheets. The ARS held by UBS are classified as trading securities and are reported at fair value with realized gains(losses) included in interest income(expense) and other, net in the condensed consolidated statements of operations. We have designated all long-term investments as available-for-sale and they are therefore reported at fair value, with unrealized gains(losses) recorded in accumulated other comprehensive income. For the three months ended June 30, 2010, we recorded a realized loss of $817,000 on re-valuation of the ARS put option, offset with a realized gain of $817,000 on the ARS held by UBS, for a net realized gain (loss) of zero. For the six months ended June 30, 2010, we recorded a realized loss of $1.3 million on re-valuation of the ARS put option, offset with a realized gain of $1.3 million on the ARS held by UBS, for a net realized gain (loss) of zero. For the three months ended June 30, 2009, we recorded a realized losses of $1.6 million on the ARS put option re-valuation, offset by a realized gains of $1.8 million on the UBS ARS, for net realized gains of $218,000. For the six months ended June 30, 2009, we had net realized gains(losses) of zero as the put option re-valuation fully offset the UBS ARS re-valuation. We recorded net unrealized losses on available-for-sale securities of $171,000 and $61,000 at June 30, 2010 and December 31, 2009, respectively.

We monitor our investments for impairment on a quarterly basis and determine whether a decline in fair value is other-than-temporary by considering factors such as current economic and market conditions, the credit rating of the security s issuer, the length of time an investment s fair value has been below our carrying value, the Company s intent to sell the security and, the Company s belief that it will not be required to sell the security before the recovery of its amortized cost. If an investment s decline in fair value is deemed to be other-than-temporary, we reduce its carrying value to its estimated fair value, as determined based on quoted market prices or liquidation values. Declines in value judged to be other-than-temporary, if any, are recorded in operations as incurred. At June 30, 2010, the Company evaluated its unrealized gains(losses) on available-for-sale securities and determined them to be temporary. The ARS investments have been in a continuous unrealized loss position for more than 12 months. In accordance with ASC 320 (formerly, FSP No. 115-2, Investments-Debt and Equity Securities), the Company concluded that it does not intend to sell a security with an unrealized loss and it will not be required to sell the security before the recovery of its amortized cost basis.

The following is a summary of cash, cash equivalents and investments at June 30, 2010 and December 31, 2009 (in thousands):

As of June 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Realized Losses	Fair Value
Cash	$ 6,252	$	$	$	$ 6,252
Money Market Funds	23,234				23,234
Certificates of Deposit	480	0			480
Commercial Paper	7,494	0	(2)		7,492
Corporate Bonds	20,433	4	(34)		20,403
Corporate Notes	4,040	11			4,051
Treasuries	5,002	0	(4)		4,998
Auction-rate Securities	12,200		(146)		12,054
	$ 79,135	$ 15	$ (186)	$	$ 78,964

Classified as:									
Cash and cash equivalents	$	32,486	$		$		$	$	32,486
Short-term investments		43,549		15		(40)			43,524
Long-term investments		3,100				(146)			2,954
	$	79,135	$	15	$	(186)	$	$	78,964

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Realized Losses	Fair Value
Cash	$ 3,429	$	$	$	$ 3,429
Money Market Fund	20,118				20,118
Certificates of Deposit	1,200				1,200
Agency Bonds	3,500	2	(1)		3,501
Commercial Paper	7,895	1	(0)		7,896
Corporate Bonds	12,384	27	(7)		12,404
Corporate Notes	8,203	73			8,276
U.S. Government Agency Securities	4,000	0			4,000
Auction-rate Securities[1]	24,100		(156)	(1,289)	22,655[1]
	$ 84,829	$ 103	$ (164)	$ (1,289)	$ 83,479[1]
Classified as:					
Cash and cash equivalents	$ 23,547	$	$	$	$ 23,547
Short-term investments	57,682	103	(8)	(1,289)	56,488
Long-term investments	3,600		(156)		3,444
	$ 84,829	$ 103	$ (164)	$ (1,289)	$ 83,479[1]

(1) In addition to the fair value of our auction-rate securities holdings, we hold the auction-rate security put option, which is classified as a short-term asset valued at $1.3 million as of December 31, 2009. At December 31, 2009, the fair value of cash, cash equivalents, investments and the auction-rate security put option was $84.8 million.

The following tables summarize the estimated fair value of our available-for-sale and trading debt securities classified by the stated maturity date of the security at June 30, 2010 and December 31, 2009:

As of June 30, 2010	
Due within one year	$ 42,362
Due within two years	$ 4,162
Due after three years	$ 2,954

As of December 31, 2009	
Due within one year	$ 33,591
Due within two years	$ 3,686
Due after three years	$ 22,655

At June 30, 2010 and December 31, 2009 we had investments in AAA-rated ARS with various state student loan authorities with estimated fair values of $12.1 million and $22.7 million, respectively. The student loans made by these authorities are substantially guaranteed by the federal government through the Federal Family Education Loan Program (FFELP). ARS are long-term floating rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (e.g., every seven days, twenty-eight days, thirty-five days, or every six months), based on market demand, if the auctions are successful. ARS are bought and sold in the marketplace through a competitive bidding process often referred to as a Dutch auction. If there is insufficient interest in the securities at the time of an auction, the auction may not be completed and the ARS then pays a default interest rate. Following such a failed auction, we cannot access our funds that are invested in the corresponding ARS until a future auction of these investments is successful, new buyers express interest in purchasing these securities in between reset dates, issuers establish a different form of financing to replace these securities or final payments become due according to contractual maturities. Commencing in February 2008, conditions in the global credit markets resulted in failed auctions for all of our ARS. In the near term, our ability to liquidate our investments or fully recover the carrying values may be limited or not exist.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In October 2008, UBS extended an offer of rights to us to sell our eligible ARS at par value back to UBS beginning June 30, 2010 through July 2, 2012. All of the UBS ARS qualify as eligible for purposes of the rights offer. In November 2008, we elected to accept the offer of rights from UBS, which gave us the option to sell to UBS a total of $20.2 million at par value at any time beginning June 30, 2010 through July 2, 2012. Upon acceptance of the UBS rights offer, we elected to value the ARS put option at fair value as allowed under ASC 825 (formerly, SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities).* Refer to the Auction-Rate Securities Put Option section below for further discussion. Given the UBS rights offer, we have elected a one-time transfer of our UBS ARS from available-for-sale to trading securities in accordance with ASC 320 (formerly FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115)). The transfer to trading securities reflects management s intent to exercise its ARS put option during the period June 30, 2010 to July 2, 2012. On June 30, 2010, we exercised our rights under the Rights Agreement with UBS. Of the $20.2 million par value we held immediately prior to exercising the put, $11.1 million was settled on June 30, 2010 while the remaining $9.1 million was settled on July 1, 2010.

We determined that the gross unrealized losses on our available-for-sale investments as of June 30, 2010 are temporary in nature. The fair value of our ARS at June 30, 2010 reflects an unrealized loss of $146,000, entirely related to securities classified as available-for-sale.

Given the exercise of our rights under the Rights Agreement on June 30, 2010, guaranteeing the Company redemption of the UBS ARS at par value, the fair value of our UBS ARS holdings was valued at par at June 30, 2010. Fair value for non-UBS ARS, classified as available-for sale, was based on a discounted cash flow valuation that takes into account a number of factors including the weighted average remaining term (WART) of the underlying securities, the expected return, and the discount rate. The actual WART from servicing reports was used where available. For securities where the actual WART was not available an estimate based on other securities held was used. The expected return was calculated based on the last twelve months average for the 91 day T-bill plus a spread. This rate is the typical default rate for ARS held by us. The discount rate was calculated using the 3-month LIBOR rate plus adjustments for the security type. Changes in any of the above estimates, especially the weighted average remaining term or the discount rate, could result in a material change to the fair value. Presently we have determined the decline in value for the available-for-sale ARS to be temporary because i) we have no intent to sell the security, and we believe that we will not be required to sell the security before the recovery of its amortized cost due to our cash reserves; ii) through June 30, 2010 all of the securities have maintained AAA credit ratings; and iii) loans made by the issuers are backed by the federal government. In accordance with FSP No. 115-2, we also conclude that we do not intend to sell an impaired available-for-sale security and will not be required to sell such a security before the recovery of our amortized cost.

However, if circumstances change, we may be required to record an other-than-temporary impairment charge on the available-for-sale ARS. We may similarly be required to record other-than-temporary impairment charges if the ratings on any of these securities are reduced or if any of the issuers default on their obligations. In addition to impairment charges, any of these events could cause us to lose part or all of our investment in these securities. Any of these events could materially affect our results of operations and our financial condition. We currently believe these securities are not significantly impaired for the reasons described above; however, it could take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

Auction-Rate Securities Put Option

In November 2008, we signed a Rights Agreement with UBS concerning the disposition of our ARS. The UBS agreement gives us the right to sell our ARS back to UBS, at par value, beginning June 30, 2010 through July 2, 2012. The rights represent a freestanding financial instrument for accounting purposes. As noted above, we elected to value this put option at fair value as allowed under ASC 825 (formerly SFAS No. 159). As such, we recognized the value of the repurchase right as an asset with the corresponding gain recorded in earnings. Fair value was determined using a with and without approach based on a discounted cash flow valuation comparing the value of the auction rate securities with the put option and without it. We took into account the same factors as those used to value the auction rate securities noted above, adjusted to account for differences in cash flow timing and UBS credit risk. The value of the rights offer was recorded in interest income and expense, net. On June 30, 2010, we exercised our rights under the Rights Agreement with UBS. The value of the ARS put option at June 30, 2010 and December 31, 2009 was zero and $1.3 million, respectively.

As of June 30, 2010, our UBS ARS are presented as short-term investments on our condensed consolidated balance sheet. Since we exercised our rights under the Rights Agreement on June 30, 2010, the value of the ARS put option was zero.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Fair Value Measurements

Fair value is defined under ASC 820, *Fair Value Measurements and Disclosures,* as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; 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 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.

The Company recognizes transfers between levels at the end of each reporting period. In accordance with ASC 820, the following table represents our fair value hierarchy for our financial assets (cash equivalents and investments) and the UBS put contract measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009 (in thousands):

As of June 30, 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash	$ 6,252	$	$	$ 6,252
Money Market Funds	23,234			23,234
Certificates of Deposit	480			480
Commercial Paper		7,492		7,492
Corporate Bonds		20,403		20,403
Corporate Notes		4,051		4,051
Treasuries		4,998		4,998
Auction-rate Securities			12,054	12,054
Total	$ 29,966	$ 36,944	$ 12,054	$ 78,964

As of December 31, 2009	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash	$ 3,429	$	$	$ 3,429
Money Market Funds	21,318			21,318
Agency Bonds		3,501		3,501
Commercial Paper		7,896		7,896
Corporate Bonds		12,404		12,404

Corporate Notes		8,276		8,276
U.S Government Agency Securities		4,000		4,000
Auction-rate Securities			22,655	22,655
Auction-rate Securities Put Option			1,289	1,289
Total	$ 24,747	$ 36,077	$ 23,944	$ 84,768

Level 2 securities are priced using quoted market prices for similar instruments, nonbinding market prices that are corroborated by observable market data, or discounted cash flow techniques. There have been no transfers between Level 1 and Level 2 measurements during the six months ended June 30, 2010.

Level 3 assets consist of non-UBS ARS with various state student loan authorities and (for reporting periods prior to June 30, 2010) the ARS put option. Beginning in February 2008, all auctions for the ARS have failed. Based on the continued failure of these auctions and the underlying maturities of the securities, we continue to classify our non-UBS holdings as long-term assets. The fair value of the auction-rate securities as of June 30, 2010 and December 31, 2009 was estimated by management.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table provides a summary of changes in fair value of our Level 3 financial assets as of June 30, 2010 and 2009 (in thousands):

	Three Months Ended June 30, 2010		Three Months Ended June 30, 2009	
	Auction-Rate Securities	Auction-Rate Securities Put Option	Auction-Rate Securities	Auction-Rate Securities Put Option
Beginning balance at March 31	$ 22,805	$ 817	$ 18,216	$ 5,037
Transfer into Level 3				
Sales	(11,500)			
Total gains/(losses):				
Included in interest income (expense) and other, net	817	(817)	1,831	(1,613)
Included in other comprehensive income	(68)		259	
Ending balance at June 30	$ 12,054	$	$ 20,306	$ 3,424

	Six Months Ended June 30, 2010		Six Months Ended June 30, 2009	
	Auction-Rate Securities	Auction-Rate Securities Put Option	Auction-Rate Securities	Auction-Rate Securities Put Option
Beginning balance at December 31	$ 22,655	$ 1,289	$ 15,766	$ 7,148
Transfer into Level 3				
Sales	(11,800)			
Total gains/(losses):				
Included in interest income (expense) and other, net	1,289	(1,289)	3,724	(3,724)
Included in other comprehensive income	(90)		816	
Ending balance at June 30	$ 12,054	$	$ 20,306	$ 3,424

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, investments and trade accounts receivable. Our investment portfolio consists of investment grade securities. Except for obligations of the United States government and securities issued by agencies of the United States government, we diversify our investments by limiting our holdings with any individual issuer. We are exposed to credit risks in the event of default by the issuers to the extent of the amount recorded on the balance sheet. At June 30, 2010, we held approximately $12.1 million of AAA-rated student loan auction-rate debt securities. See the Cash, Cash Equivalents and Investments section of this Note 1 to the condensed consolidated financial statements for more information.

The credit risk in our trade accounts receivable is mitigated by our credit evaluation process and reasonably short payment terms. At June 30, 2010, Customer A and Customer B accounted for 54% and 28%, respectively, of our total accounts receivable. No other customers accounted for 10% of our total accounts receivable. At December 31, 2009, Customer A accounted for 80% of our total accounts receivable. No other customers accounted for 10% or over of our total accounts receivable.

For the three months ended June 30, 2010, Customer A and Customer B accounted for 42% and 13% of our total revenue. There were no other customers that accounted for 10% or more of total revenue. For the three months ended June 30, 2009, Customer A accounted for 87% of our total revenue. There were no other customers that accounted for 10% or more of total revenue. For the six months ended June 30, 2010, Customer A accounted for 47% of our total revenue. There were no other customers that accounted for 10% or more of total revenue. For the six months ended June 30, 2009, Customer A accounted for 88% of our total revenue. There were no other customers that accounted for 10% or more of total revenue.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount. We perform evaluations of our customers financial condition and generally do not require collateral. We make judgments as to our ability to collect outstanding receivables and provide allowances for a portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current payment trends. The determination of past-due accounts is based on contractual terms. At June 30, 2010 and December 31, 2009, we had an allowance for doubtful accounts of $6,000 and $9,000, respectively.

Property and Equipment

Property and equipment is stated at cost, less accumulated depreciation which is determined using the straight-line method over the estimated useful lives of 2 years for computer equipment and software, 3 years for furniture and fixtures, and the shorter of the estimated useful lives or the lease term for leasehold improvements. Repairs and maintenance costs are expensed as incurred.

Business Combinations Purchase Accounting

Under the purchase method of accounting, we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. We record the excess of purchase price over the aggregate fair values as goodwill. We engage third-party appraisal firms to assist us in determining the fair values of assets acquired and liabilities assumed. These valuations require us to make significant estimates and assumptions, especially with respect to intangible assets. Such estimates include assumptions regarding future revenue streams, market performance, customer base, and various vendor relationships. We estimate the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expenses. We estimate the future cash flows to be derived from such assets, and these estimates are used to determine the fair value of the assets. If any of these estimates change, depreciation or amortization expenses could be accelerated and the value of our intangible assets could be impaired.

Purchased Technology and Internal Use Software

We capitalize costs related to software that we license and incorporate into our product and service offerings or develop for internal use. In July 2009, we licensed source code for technology associated with remote computer access in the amount of $350,000. For the three and six months ended June 30, 2010, we recorded amortization expense related to this technology of $21,000 and $42,000, respectively. In addition, as of June 30, 2010, we are carrying $68,000 of capitalized costs incurred during the development of software for internal use. This software is not yet implemented. We will amortize this cost over the useful life of this software once it is placed into service.

Accounting for Goodwill and Other Intangible Assets

We assess the impairment of goodwill annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. We perform our annual impairment test on September 30 each year. An impairment loss would be recognized if the fair value of the reporting unit is less than the carrying value of the reporting unit s net assets on the date of the evaluation. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by our management. Our estimates of discounted cash flows may differ from actual cash flows due to, among other things, economic conditions, changes to the business model or changes in operating performance. If our estimates were to change, our assessment of goodwill impairment could change and could result in write-downs of goodwill, which would be reflected by charges to our operating results for any period presented.

We assess the impairment of identifiable intangible assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. If our estimates regarding future cash flows derived from such assets were to change, we may record an impairment to the value of these assets. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Stock-Based Compensation

We comply with ASC 718 (formerly SFAS 123R) which requires the measurement and recognition of compensation expense for all stock-based payment awards, including grants of stock and options to purchase stock, made to employees and directors based on estimated fair values.

In the second quarter of 2009 we sold our Enterprise business to Consona Corporation (Consona). This sale qualified as the sale of substantially all the assets of the business, and according to the terms of our Employee Stock Purchase Plan (ESPP), such a sale automatically terminated the ESPP. As a result of the automatic termination of the ESPP, the company reversed all ESPP expenses related to the current purchase period and refunded all amounts to the employees. The fair value of our stock options granted to employees for the three and six months ended June 30, 2010 and 2009 was estimated using the following assumptions:

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Stock Option Plan:				
Risk-free interest rate	1.5%	2.1%	1.8%	2.1%
Expected term	3.6 years	4.4 years	3.6 years	4.4 years
Volatility	66.9%	60.2%	67.7%	60.2%
Expected dividend	0%	0%	0%	0%
Weighted average fair value	$ 1.75	$ 1.09	$ 1.53	$ 1.09

We recorded the following stock-based compensation expense for the three and six months ended June 30, 2010 and 2009 (in thousands):

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Stock option compensation expense recognized in:				
Cost of service	$ 40	$ 31	$ 79	$ 65
Cost of software	0		1	
Research and development	149	93	298	197
Sales and marketing	291	132	442	360
General and administrative	552	388	1,068	771
	$ 1,032	$ 644	$ 1,888	$ 1,393
ESPP compensation expense recognized in:				
Cost of service	$	$ (4)	$	$ 3
Research and development		(3)		2
Sales and marketing		(1)		2
General and administrative		(3)		2
	$	$ (11)	$	$ 9
Stock-based compensation expense included in total costs and expenses	$ 1,032	$ 633	$ 1,888	$ 1,402

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table represents stock option activity for the six months ended June 30, 2010:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in 000 s)
Outstanding options at the beginning of the period	10,679,057	$ 2.70	5.08	$ 2,559
Granted	1,079,100	3.58		
Exercised	(155,808)	2.35		
Forfeited	(238,190)	2.73		
Outstanding options at the end of the period	11,364,159	$ 2.73	4.54	$ 16,727
Options vested and expected to vest	11,198,661	$ 2.74	4.53	$ 16,454
Outstanding and exercisable at the end of the period	3,184,682	$ 3.44	3.83	$ 2,785

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options on June 30, 2010. This amount changes based on the fair market value of our stock. During the three and six months ended June 30, 2010, the aggregate intrinsic value of options exercised under our stock option plans were $265,000 and $273,000. During the three and six months ended June 30, 2009, the aggregate intrinsic value of options exercised under our stock option plans was $180,000. Total fair value of options vested during the three and six months ended June 30, 2010 was $0.9 million and $1.8 million. Total fair value of options vested during the three and six months ended June 30, 2009 was $0.9 million and $2.1 million, respectively.

At June 30, 2010 there was $7.6 million of unrecognized compensation cost related to existing options outstanding, which is expected to be recognized over a weighted average period of 2.6 years.

Net Loss Per Share

Basic net loss per share is computed using our net loss and the weighted average number of common shares outstanding during the reporting period. Diluted net loss per share is computed using our net loss and the weighted average number of common shares outstanding, including the effect from the potential issuance of common stock such as stock issuable pursuant to the exercise of stock options using the treasury stock method when dilutive. For the three and six months ended June 30, 2010 and 2009, the outstanding options were excluded from the computation of diluted net loss per share since their effect would have been anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Loss from continuing operations	$ (6,237)	$ (4,221)	$ (10,390)	$ (12,675)
Income (loss) from discontinued operations	2	6,460	(3)	7,518

Net income (loss)	$ (6,235)	$ 2,239	$ (10,393)	$ (5,157)
Shares used in computing basic net gain (loss) per share	46,534	46,360	46,503	46,345
Shares used in computing diluted net gain (loss) per share	46,534	46,360	46,503	46,345
Basic and diluted net loss per share from continuing operations	$ (0.13)	$ (0.09)	$ (0.22)	$ (0.27)
Basic and diluted net income per share from discontinued operations	0.00	0.14	(0.00)	0.16
Basic and diluted net gain (loss) per share	$ (0.13)	$ 0.05	$ (0.22)	$ (0.11)

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Warranties and Indemnifications

We generally provide a refund period on sales, during which refunds may be granted to consumers under certain circumstances, including our inability to resolve certain support issues. For our channel sales, the refund period varies by channel partner, but is generally between 5-10 days. For referral programs and direct transactions, the refund period is generally 5 days. For all sales channels, we recognize revenue net of refunds and cancellations during the period. Refunds and cancellations have not been material.

We generally agree to indemnify our customers against legal claims that our software products infringe certain third-party intellectual property rights. As of June 30, 2010 and 2009, we have not been required to make any payment resulting from infringement claims asserted against our customers and have not recorded any related accruals.

Recent Accounting Pronouncements

In September 2009, the FASB issued Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force (ASU 2009-13) which updates the existing multiple-element revenue arrangements guidance currently included under ASC 605, which originated primarily from the guidance in EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21). The revised guidance primarily makes two significant changes: (1) it eliminates the need for objective and reliable evidence of the fair value for the undelivered element in order for a delivered item to be treated as a separate unit of accounting, and (2) it eliminates the residual method to allocate the arrangement consideration. In addition, the guidance also expands the disclosure requirements for revenue recognition. ASU 2009-13 will be effective for the first annual reporting period beginning on or after June 15, 2010, with early adoption permitted provided that the revised guidance is retroactively applied to the beginning of the year of adoption. This update is not expected to have a significant impact on our financial position.

Note 2. Discontinued Operations

Support.com, Inc., formerly SupportSoft, Inc., was founded as an enterprise software provider. In 2007, we launched a premium technology services business focused on consumers and, in 2008, reported two operating segments. The two segments were the Enterprise business (comprised of the enterprise software and related services businesses) and the Consumer business (comprised of the consumer services business). During the second quarter of 2009 we sold substantially all of the assets and transferred certain of the liabilities of our Enterprise business to Consona Corporation (Consona). The operations and cash flows of the disposed business have been completely eliminated from the ongoing operations, and in accordance with ASC 360 (formerly SFAS 131) have been presented as a discontinued operation as of June 23, 2009, and for all periods.

Operating results for the discontinued operation are listed below for the three and six months ended June 30, 2009:

	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Revenue:		
License	$ 432	$ 1,238
Maintenance	3,115	6,783
Services	2,215	4,659
Total revenue	5,762	12,680

Costs and expenses:		
Costs of license	105	215
Cost of maintenance	338	728
Cost of services	1,885	4,141
Research and development	416	849
Sales and marketing	1,403	3,970
Total costs and expenses	4,147	9,903
Income from discontinued operations, before income taxes	$ 1,615	$ 2,777

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Summary results from discontinued operations, including gain on sale and tax impact, are summarized as follows:

	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Income from discontinued operations, before income taxes	$ 1,615	$ 2,777
Gain on sale of discontinued operations	9,509	9,509
Taxes on discontinued operations	(4,664)	(4,768)
Income from discontinued operations, after income taxes	$ 6,460	$ 7,518

Income (loss) from discontinued operations, before income taxes, represents the Enterprise Business historic segment reporting, including all directly attributable revenues and costs. These revenues and costs are consistent with prior reporting methodologies, but exclude all corporate costs, primarily facilities and information technology, which were previously allocated to the segment.

Tax expenses have been attributed to discontinued operations or continuing operations based on specific analysis for federal, state and international amounts. We recorded approximately $(2,000) and $3,000 of income tax (benefit) expense related to our discontinued operations for the three and six months ended June 30, 2010. This tax benefit and expense is a result of additional foreign interest build netted against releases of previously booked tax reserves.

Note 3. Comprehensive Loss

Comprehensive net income/loss includes the impact of foreign currency translation adjustments and changes in the fair value of available-for-sale securities. The following are the components of comprehensive loss (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income/(loss)	$ (6,235)	$ 2,239	$ (10,393)	$ (5,157)
Net unrealized gain on available-for-sale securities	131	350	110	901
Foreign currency translation gain/(loss)	(33)	(79)	5	(133)
Total comprehensive income/(loss)	$ (6,137)	$ 2,510	$ (10,278)	$ (4,389)
Income tax provision netted against unrealized gain (loss) on available-for-sale securities	$	$	$	$
Income tax benefit netted against foreign currency translation loss	$ (36)	$ (23)	$ (61)	$ (61)

Note 4. Income Taxes

As a result of the sale of our Enterprise Business to Consona (see Note 2 for details), we are reporting all historical financial activity for that segment including revenues, direct expenses, gain on sale, and the tax impact of the gain on the sale as discontinued operations. The income tax provision reported in this footnote relates to the tax position of our continuing operations.

We recorded an income tax provision of $10,000 and $22,000 for the three months and six months ended June 30, 2010, respectively. These provisions primarily reflect tax expense associated with state income taxes. For the three and six months ended June 30, 2009 the Company recorded an income tax benefit of $2.8 million and $2.8 million, respectively. These provisions primarily reflected the benefit of utilization of continuing operations tax attributes given the impact of the tax on the income from discontinued operations (for the 2009 periods) (see Note 2).

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SUPPORT.COM, INC.

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(Unaudited)

As of June 30, 2010, our deferred tax assets are fully offset by a valuation allowance except in those jurisdictions where it is determined that a valuation allowance is not required. ASC 740 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes historical operating performance, reported cumulative net losses since inception and difficulty in accurately forecasting our future results, we provided a full valuation allowance against our net U.S. deferred tax assets and a full valuation allowance on certain foreign deferred tax assets. We reassess the need for our valuation allowance on a quarterly basis. If it is later determined that a portion of the valuation allowance should be reversed it generally will be a benefit to the income tax provision.

Note 5. Contingencies

Tax contingencies

We are required to make periodic filings in the jurisdictions where we are deemed to have a presence for tax purposes. We have undergone audits in the past and have paid assessments arising from these audits. During the fourth quarters of 2008 and 2009, our India entity was issued notices of income tax assessment pertaining to the 2004-2005 and 2005-2006 fiscal years. The notices claimed that the transfer price used in our inter-company agreements with our India entity was too low, and that the rate should be increased. We believe our current transfer pricing position is more likely than not to be sustained. We believe that this will be resolved through the normal judicial appeal process used in India, and have submitted our case to the court.

We may be subject to other income tax assessments in the future. We evaluate estimated losses that could arise from those assessments in accordance with ASC 740. We consider such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate on the amount of loss. We record the estimated liability amount for those assessments that we consider to be more likely than not in our balance sheet.

Legal contingencies

In November 2001, a class action lawsuit was filed against us, two of our former officers and certain underwriters in the United States District Court for the Southern District of New York. Similar complaints have been filed against 55 underwriters and more than 300 other companies and other individual officers and directors of those companies; the consolidated case is *In re Initial Public Offering Securities Litigation*, No. 21 MC 92 (SAS) (S.D.N.Y.). The lawsuit, which sought unspecified damages, fees and costs, alleged that our registration statement and prospectus dated July 18, 2000 for the issuance and initial public offering of 4,250,000 shares of our common stock contained material misrepresentations and/or omissions related to alleged inflated commissions received by the underwriters of the offering. On April 1, 2009, all parties entered into a Stipulation and Agreement of Settlement that would resolve all claims and dismiss the case against us and our former officers, without any payment by us or our former officers. On October 5, 2009, the court issued an order approving the settlement. Certain other parties have appealed the settlement and the appeal is pending.

We are also subject to other routine legal proceedings, as well as demands, claims and threatened litigation, that arise in the normal course of its business, potentially including assertions that we may be infringing patents or other intellectual property rights of others. We currently do not believe that the ultimate amount of liability, if any, for any pending claims of any type (alone or combined) will materially affect our financial position, results of operations or cash flows. The ultimate outcome of any litigation is uncertain, however, and unfavorable outcomes could have a material negative impact on our financial condition and operating results. Regardless of outcome, litigation can have an adverse impact on us because of defense costs, negative publicity, diversion of management resources and other factors.

Note 6. Restructuring Obligations and Other Charges

In the first quarter of 2009, we implemented a reduction in our workforce and closed certain facilities worldwide in order to reduce our ongoing cost structure. We reduced our workforce by 17 employees, or approximately 6% of our non-agent headcount. All of the affected employees were terminated as of March 31, 2009. As a result, we recorded a restructuring charge of $896,000 in the first quarter of 2009. The restructuring charge was primarily comprised of employee termination costs, professional services costs and facilities impairment costs. Restructuring and impairment expenses included in the condensed consolidated statement of operations totaled $821,000 in discontinued operations and $75,000 in continuing operations, including $6,000 for sales and marketing and $69,000 for general and administrative. As of June 30, 2010, the remaining balance of the restructuring obligation was $231,000, related to one facility in the United Kingdom, which we expect to pay through 2011.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In the third quarter of 2009, we ceased using a portion of our headquarters office in order to align our facilities usage with our current size. As a result, we impaired approximately 46% of our Redwood City facility. We recorded a restructuring charge of approximately $1.3 million, which related to the facility impairment and is included in our general and administrative expenses in our consolidated statement of operations. As of June 30, 2010, the remaining balance on this restructuring obligation was $717,000, which we expect to pay through 2012.

The following table summarizes activity associated with the restructuring and related expenses incurred from December 31, 2009 through June 30, 2010 (in thousands):

	Facilities(1)	Total
Restructuring obligations, December 31, 2009	$ 1,242	$ 1,242
Cash payments	(294)	(294)
Restructuring obligations, June 30, 2010	$ 948	$ 948

(1) Facilities costs include obligations under non-cancelable leases for facilities that we will no longer occupy, as well as penalties associated with early terminations of leases and disposal of fixed assets. No sublease income has been included because subleasing is not permitted under the terms of our lease.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the related notes included elsewhere in this Form 10-Q (the Report) and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2008. The following discussion includes forward-looking statements. Please see Risk Factors in Item 1A of Part II of this Report for important information to consider when evaluating these statements.

Overview

Support.com provides services and software that help consumers and small businesses with their technology needs.

Our technology services and software products install, set-up, connect, repair and protect personal computers and related devices that are essential to our customers. We offer one-time services and subscription service plans, and we also license software products to consumers who prefer do-it-yourself solutions.

Our Personal Technology Experts deliver our services online and by telephone, leveraging our proprietary technology platform. They are based in North America and work from their homes rather than in brick and mortar facilities. Our software products include award-winning tools designed to address some of the most common PC problem areas, including Windows registry errors, hard disk management and computer memory optimization.

We market our services through channel partners and directly to consumers. Our channel partners include leading retail, software, PC/CE and internet service brands. We market our software products directly to consumers and through channel partners using free trial versions. Our sales and marketing efforts principally target North American consumers.

In the second quarter of 2010, our revenue grew substantially over 2009 results, but remained flat against first quarter 2010 results. Our year-over-year growth was driven by the addition of new service programs, the expansion of existing programs, and increased sales of our software products, acquired in December 2009. Our performance against first quarter results was impacted by negative second quarter seasonality offsetting growth from newer services programs expansion. In order to support the growth of our services program and to address service level requirements, especially launches of in-store remote services for newer programs, we hired a substantial number of Personal Technology Experts during the first and second quarters. When newer programs grew more slowly than anticipated, the increase to our staffing had a material impact on our margins for the second quarter. Despite the adverse effect on our second quarter margins, we believe that these staffing investments will drive long term success for both our partners and the Company.

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In the third quarter of 2010, we expect total revenue to grow as compared to the second quarter of 2010. We expect our operating losses to be consistent with the first quarter or to decline.

Critical Accounting Policies and Estimates

In preparing our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States, we make assumptions, judgments and estimates that can have a significant impact on our net revenue, and operating results, as well as on the value of certain assets and liabilities on our condensed consolidated balance sheet. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, fair value measurements, fair value estimates ARS put option, business combinations purchase accounting, accounting for goodwill and other intangible assets, stock-based compensation and accounting for income taxes have the greatest potential impact on our condensed consolidated financial statements, so we consider these to be our critical accounting policies. We discuss below the critical accounting estimates associated with these policies. For further information on the critical accounting policies, see Note 1 of our Notes to Condensed Consolidated Financial Statements.

Revenue Recognition

Our revenue recognition policy is one of our critical accounting policies because revenue is a key component of our results of operations and revenue recognition is based on complex rules which require us to make judgments. In applying our revenue recognition policy we must determine whether revenue is to be recognized on a gross or net basis in accordance with the provisions of ASC 605, *Revenue Recognition*, which portions of our revenue are to be recognized in the current period, and which portions must be deferred and recognized in subsequent periods. We also recognize services breakage on non-subscription deferred revenue balances, and we use judgment in evaluating the historical redemption patterns used to estimate services breakage. We do not record revenue on sales transactions when the collection of cash is in doubt at the time of sale, and we use management judgment in determining collectability. From time to time, we may enter into agreements which involve us making payments to our channel partners. We use judgment in evaluating the treatment of such payments and in determining which portions of the consideration paid to customers should be recorded as contra-revenue and which should be recorded as an expense. We generally provide a refund period on services and software, and we employ judgment in determining whether a customer is eligible for a refund based on that customer s specific facts and circumstances. If our estimates and judgments on any of the foregoing are incorrect, our revenue for one or more periods may be incorrectly recorded. Please see Note 1 in Notes to condensed consolidated financial statements for further discussion of our revenue recognition policies.

Fair Value Measurements

Effective January 1, 2008, we adopted ASC 820, *Fair Value Measurements and Disclosures,* which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities. Therefore, determining fair value for Level 1 instruments generally does not require significant management judgment, and the estimation is not difficult.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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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. The determination of fair value for Level 3 instruments requires the most management judgment and subjectivity.

Our Level 2 securities are priced using quoted market prices for similar instruments, nonbinding market prices that are corroborated by observable market data, or discounted cash flow techniques. There have been no transfers between Level 1 and Level 2 measurements during the three and six months ended June 30, 2010.

Our Level 3 assets consist of auction-rate securities (ARS) with various state student loan authorities, and an ARS put option with UBS (as described below). Beginning February 2008, all auctions for the ARS have failed. Based on the continued failure of these auctions and the underlying maturities of the securities, we continue to classify our non-UBS holdings as long-term assets. On June 30, 2010, we exercised our rights under the Rights Agreement with UBS and we settled the cash on June 30, 2010 and July 1, 2010. The fair value of our ARS holdings was estimated by management using assumptions regarding market volatility and discount rates. If any of these estimates change, the value of Level 3 assets could change in future periods.

Fair Value Estimates- ARS Put Option

In November, 2008, we signed a Rights Agreement with UBS concerning the disposition of its ARS. The UBS agreement gave us the right to sell our ARS holdings back to UBS, at par value, beginning June 30, 2010 through July 2, 2012. On June 30, 2010, we exercised our rights under the Rights Agreement with UBS. This right represented a freestanding financial instrument for accounting purposes. We elected to value this put option at fair value. We recognized the value of the repurchase right as an asset with corresponding gain/loss recorded in earnings. Fair value was determined using a with and without approach, based on a discounted cash flow valuation comparing the value of the auction rate securities with the put option and without it. We took into account the same factors as those used to value the auction rate securities noted above. The value of the rights offer was recorded in interest income (expense), net on our consolidated statement of operations.

We previously made certain estimates in calculating the fair value of the ARS put option for our UBS securities, including estimates for the weighted average remaining term (WART) of the underlying securities in which actual WART from servicing reports was unavailable, the expected return, and the discount rate. Since our rights under the Rights Agreement were exercised on June 30, 2010, the value of the ARS Put Option was written down to zero as of June 30, 2010.

Business Combinations - Purchase Accounting

Under the purchase method of accounting, we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. We record the excess of purchase price over the aggregate fair values as goodwill. We engage third-party appraisal firms to assist us in determining the fair values of assets acquired and liabilities assumed. These valuations require us to make significant estimates and assumptions, especially with respect to intangible assets. Such estimates include assumptions regarding future revenue streams, market performance, customer base, and various vendor relationships. We estimate the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expenses. We estimate the future cash flows to be derived from such assets, and these estimates are used to determine the fair value of the assets. If any of these estimates change, depreciation or amortization expenses could be accelerated and the value of our intangible assets could be impaired.

Accounting for Goodwill and Other Intangible Assets

We assess the impairment of goodwill annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss would be recognized if the fair value of the reporting unit is less than the carrying value of the reporting unit s net assets on the date of the evaluation. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by our management. Our estimates of discounted cash flows may differ from actual cash flows due to, among other things, economic conditions, changes to the business model or changes in operating performance. If our estimates were to change, our assessment of goodwill impairment could change and could result in write-downs of goodwill, which would be reflected by charges to our operating results for any period presented.

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We assess the impairment of identifiable intangible assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. If our estimates regarding future cash flows derived from such assets were to change, we may record an impairment to the value of these assets. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value.

Stock-Based Compensation

We account for stock-based compensation in accordance with the provisions of ASC 718, *Compensation Stock Compensation*. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. We estimate the fair value of stock-based awards on the grant date using the Black-Scholes-Merton option-pricing model. Determining the appropriate fair value model and calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life. If any of these assumptions used in the option-pricing models change, our stock-based compensation expense could change on our financial statements.

Accounting for Income Taxes

We are required to estimate our income taxes in each of the tax jurisdictions in which we operate. This process involves management s estimation of our current tax exposures together with an assessment of temporary differences determined based on the difference between the financial statement and tax basis of certain items. These differences result in net deferred tax assets and liabilities, which are included in our condensed consolidated balance sheet. We must assess the likelihood that we will be able to recover our deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. We currently have provided a full valuation allowance on our U.S deferred tax assets and a full valuation allowance on our foreign deferred tax assets. If any of our estimates change, we may change the likelihood of recovery and our tax expense as well as the value of our deferred tax assets would change.

Our income tax calculations are based on application of the respective U.S. federal, state or foreign tax law. Support.com s tax filings, however, are subject to audit by the respective tax authorities. Accordingly, we recognize tax liabilities based upon our estimate of whether, and the extent to which, additional taxes will be due when such estimates are more-likely-than-not to be sustained. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. To the extent the final tax liabilities are different than the amounts originally accrued, the increases or decreases are recorded as income tax expense or benefit in the condensed consolidated statements of operations.

RESULTS OF OPERATIONS

The following table sets forth the results of operations for the three and six months ended June 30, 2010 and 2009 expressed as a percentage of total revenue.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Revenue:				
Services	70%	98%	69%	98%
Software and other	30	2	31	2
Total revenue	100	100	100	100
Costs of revenue:				
Cost of services	74	125	65	123
Cost of software and other	3	0	3	0
Total cost of revenue	77	125	68	123
Gross profit (loss)	23	(25)	32	(23)

Operating expenses:				
Research and development	13	47	13	47
Sales and marketing	44	58	42	58
General and administrative	29	87	30	93
Amortization of intangible assets	1	1	1	1
Total operating expenses	87	193	86	199
Loss from operations	(64)	(218)	(54)	(222)
Interest and other income, net	2	12	2	2
Loss from continuing operations, before income taxes	(62)	(206)	(52)	(220)
Provision/(benefit) for income taxes	0	(83)	0	(40)
Loss from continuing operations	(62)	(123)	(52)	(180)
Income from discontinued operations, after income taxes	0	188	0	107
Net income/(loss)	(62)%	65%	(52)%	(73)%

REVENUE

	Three Months Ended June 30,				Six Months Ended June 30,			
In thousands, except percentages	**2010**	**2009**	**$ Change**	**% Change**	**2010**	**2009**	**$ Change**	**% Change**
Services	$ 6,882	$ 3,374	$ 3,508	104%	$ 13,612	$ 6,926	$ 6,686	97%
Software and other	3,004	59	2,945	4,992%	6,133	121	6,012	4,969%
Total revenue	$ 9,886	$ 3,433	$ 6,453	188%	$ 19,745	$ 7,047	$ 12,698	180%

Services revenue consists primarily of fees for technology services provided either through our channel partners or directly via our website www.support.com. The increase in services revenue for the three and six months ended June 30, 2010 compared to the same quarters of 2009 was primarily the result of expansion in our channel partnerships.

Software and other revenue was comprised primarily of fees for software products provided through direct consumer downloads and, to a lesser extent, through the sale of this software via channel partners. The increase in software and other revenue for the three and six months ended June 30, 2010 compared to the same quarters of 2009 was the result of growing revenue from the Sammsoft line of software products acquired from Xeriton, Inc. in December 2009.

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COSTS AND EXPENSES

Costs of Revenue

	Three Months Ended June 30,				Six Months Ended June 30,			
In thousands, except percentages	**2010**	**2009**	**$ Change**	**% Change**	**2010**	**2009**	**$ Change**	**% Change**
Cost of services	$ 7,346	$ 4,283	$ 3,063	72%	$ 12,830	$ 8,656	$ 4,174	48%
Cost of software and other	335		335	100%	683		683	100%
Total cost of revenue	$ 7,681	$ 4,283	$ 3,398	79%	$ 13,513	$ 8,656	$ 4,857	56%

Cost of services. Cost of services consists primarily of salary and related expenses for our Personal Technology Experts, technology and telecommunication expenses related to the delivery of services and other employee-related expenses for our service delivery organization. The increase in cost of services for the three and six months ended June 30, 2010 compared to the same quarters of 2009 was primarily due to increase in salary and related overhead expense as a result of growing our workforce of Personal Technology Experts.

Cost of software and other. Cost of software and other fees consists primarily of third-party royalty fees for the Sammsoft line of software products we acquired in December 2009. Certain of these products were developed using third-party research and development resources. The third party developer receives royalty payments for any products it develops that we sell. The increase in cost of software and other for the three and six months ended June 30, 2010 compared to the same quarters of 2009 was due to the initiation of the contractual relationship with the third-party developer in December 2009 in connection with the purchase of the Sammsoft line of products.

Operating Expenses

	Three Months Ended June 30,				Six Months Ended June 30,			
In thousands, except percentages	**2010**	**2009**	**$ Change**	**% Change**	**2010**	**2009**	**$ Change**	**% Change**
Research and development	$ 1,281	$ 1,605	$ (324)	(20)%	$ 2,624	$ 3,303	$ (679)	(21)%
Sales and marketing	$ 4,320	$ 2,007	$ 2,313	115%	$ 8,291	$ 4,058	$ 4,233	104%
General and administrative	$ 2,887	$ 2,980	$ (93)	(3)%	$ 5,839	$ 6,578	$ (739)	(11)%

Research and development. Research and development costs are expensed as incurred. Research and development expense consists primarily of compensation costs, third-party consulting expenses and related overhead costs for research and development personnel. The decrease in research and development expense for the three and six months ended June 30,2010 compared to the same quarters of 2009 resulted primarily from lower salary and related expenses due to fewer research and development personnel following the sale of our Enterprise business.

Sales and marketing. Sales and marketing expense consists primarily of compensation costs, including salaries and sales commissions for sales, business development and marketing personnel expenses for lead generation activities and promotional expenses, including public relations, advertising and marketing activities. The increase in sales and marketing expense for the three and six months ended June 30, 2010, compared to the same quarters of 2009 resulted primarily from higher marketing expense to drive software sales and to a lesser extent from increased sales and marketing personnel staffing and related costs.

General and administrative. General and administrative expense consists primarily of compensation costs and related overhead costs for administrative personnel and professional fees for legal, accounting and other professional services. The decrease in general and administrative expense for the three and six months ended June 30, 2010 compared to the same quarters of 2009 resulted primarily from lower salary and related expense due to fewer personnel and lower facilities and professional services costs.

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Amortization of Intangible Assets

	Three Months Ended June 30,				Six Months Ended June 30,			
In thousands, except percentages	**2010**	**2009**	**$ Change**	**% Change**	**2010**	**2009**	**$ Change**	**% Change**
Amortization of intangible assets	$ 93	$ 42	$ 51	121%	$ 181	$ 84	$ 97	115%

The increase in amortization of intangible assets for the three and six months ended June 30, 2010 compared to the same quarters of 2009 was a result of additional amortization expense related to intangible assets acquired as part of the purchase of the Sammsoft line of software products in December 2009.

INTEREST INCOME AND OTHER, NET

	Three Months Ended June 30,				Six Months Ended June 30,			
In thousands, except percentages	**2010**	**2009**	**$ Change**	**% Change**	**2010**	**2009**	**$ Change**	**% Change**
Interest income and other, net	$ 149	$ 422	$ (273)	(65)%	$ 335	$ 120	$ 215	179%

For the three months ended June 30, 2010, the decrease in interest income and other resulted primarily from lower average investment balances on our marketable securities. During the second quarter of 2009, we recorded a realized gain of $218,000, net, related to a gain of $1.8 million to adjust the value of UBS ARS to fair value and a loss of $1.6 million on ARS put option. During the second quarter of 2010, the change in value of our ARS put option fully offset the change in value of our UBS ARS. For the six months ended June 30, 2010, the increase in interest income and other resulted from higher interest rate in year 2010 compared to year 2009. In 2009, we recorded a realized loss of $126,000 on our cash receipt due to exchange rate fluctuation . For the six months ended June 30, 2010 and 2009, the change in value of our ARS put option fully offset the change in value of our UBS ARS.

PROVISION FOR INCOME TAXES

	Three Months Ended June 30,				Six Months Ended June 30,			
In thousands, except percentages	**2010**	**2009**	**$ Change**	**% Change**	**2010**	**2009**	**$ Change**	**% Change**
Provision/(benefit) for income taxes	$ 10	$ (2,841)	$ (2,851)	100%	$ 22	$ (2,837)	$ (2,859)	101%

The income tax provision in 2010 related to continuing operations are primarily comprised of the tax expense associated with state income taxes. In accordance with ASC 740, no material increase or decrease in unrecognized tax benefits was included in the quarterly provision for the three or six months ended June 30, 2010 and 2009, respectively.

The increase in the provision (benefit) for income taxes from 2009 to 2010 resulted from the utilization of continuing operations tax attributes to offset the tax reported as part of discontinued operations during 2009.

LIQUIDITY AND CAPITAL RESOURCES

Total cash, cash equivalents, investments and the auction-rate securities put option at June 30, 2010 was $79.0 million. This balance presents an $5.8 million decrease from the balance of $84.8 million at December 31, 2009.

Operating Activities

Net cash used in operating activities was $5.4 million and $13.5 million for the six months ended June 30, 2010 and 2009, respectively. Net cash used in operating activities for the six months ended June 30, 2010 resulted primarily from a net loss of $10.4 million, offset by an increase of accounts payable of $1.0 million and accrued compensation of $1.5 million, and non-cash items of $2.7 million, which primarily include depreciation, amortization of premiums and discounts on marketable securities, stock-based compensation expense and amortization of intangible assets. Net cash used in operating activities for the six months ended June 30, 2009 resulted primarily from a net loss of $5.2 million, a reduction in deferred revenue for discontinued operations of $1.5 million and a gain on the sale of the Enterprise Business of $4.7 million, partially offset by non-cash items of $2.8 million. Such items primarily include depreciation, write-off of fixed assets, amortization of premiums and discounts on marketable securities, stock-based compensation expenses and amortization of intangible assets.

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Investing Activities

Net cash provided by investing activities for the six months ended June 30, 2010 was primarily due to sales and maturities of $38.5 million in investments offset by the purchases of $24.3 million in investments and expenditures of $181,000 for property and equipment. Net cash provided by investing activities for the six months ended June 30, 2009 was primarily due to the proceeds from the sale of the Enterprise Business of $20.5 million and sales and maturities of $7.9 million in investments offset by the purchases of $13.4 million in investments.

Financing Activities

Net cash provided by financing activities was $365,000 and $265,000 for the six months ended June 30, 2010 and 2009, respectively. Net cash provided by financing activities for the six months ended June 30, 2010 was attributable to the exercise of 155,808 common shares employee stock options. Net cash provided by financing activities for the six months ended June 30, 2009 resulted from net proceeds from the purchase of 74,041 common shares under the ESPP and net proceeds from the issuance of 146,239 common shares under the 2000 Omnibus Equity Incentive Plan.

Working Capital and Capital Expenditure Requirements

At June 30, 2010, we had stockholders equity of $88.1 million and working capital of $73.3 million. We believe that our existing cash balances will be sufficient to meet our working capital requirements for at least the next 12 months.

If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may seek to sell additional equity or debt securities. The sale of additional equity could result in more dilution to our stockholders.

We plan to continue to make investments in our business during 2010. We believe these investments are essential to creating sustainable growth in our business in the future. Because these investments will likely precede any associated revenues, we expect our working capital to decrease in the near term. Additionally, we may choose to acquire other businesses or complimentary technologies to enhance our product capabilities and such acquisitions would likely require the use of cash.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Market Risk

There has been significant deterioration and instability in the financial markets since 2008. This extraordinary disruption and readjustment in the financial markets exposes us to additional investment risk. The value and liquidity of the securities in which we invest could deteriorate rapidly and the issuers of such securities could be subject to credit rating downgrades. In light of the current market conditions and these additional risks, we actively monitor market conditions and developments specific to the securities and security classes in which we invest. While we believe we take prudent measures to mitigate investment related risks, such risks cannot be fully eliminated, as there are circumstances outside of our control.

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. To achieve this objective, we invest our excess cash in a variety of securities, including U.S government agency securities, ARS, corporate notes and bonds, commercial paper and money market funds meeting certain criteria. These securities are classified as available-for-sale, except for our UBS ARS holdings, which are classified as trading. Consequently, our available-for-sale securities are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss). Our holdings of the securities of any one issuer, except government agencies, do not exceed 10% of our portfolio. We do not utilize derivative financial instruments to manage our interest rate risks.

As of June 30, 2010, we held $46.5 million in investments (excluding cash and cash equivalents), which consisted primarily of government debt securities, ARS, corporate notes and bonds, and commercial paper. The weighted average interest rate of our portfolio was approximately 3.13% at June 30, 2010. A decline in interest rates over time would reduce our interest income from our investments. A decrease in interest rates of 100 basis points would cause a corresponding decrease in our annual interest income of approximately $465,000.

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At June 30, 2010 and December 31, 2009 we had investments in AAA-rated ARS with various state student loan authorities with estimated fair values of $12.1 million and $22.7 million, respectively. The student loans made by these authorities are substantially guaranteed by the federal government through the Federal Family Education Loan Program (FFELP). ARS are long-term floating rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (e.g., every seven days, twenty-eight days, thirty-five days, or every six months), based on market demand, if the auctions are successful. ARS are bought and sold in the marketplace through a competitive bidding process often referred to as a Dutch auction. If there is insufficient interest in the securities at the time of an auction, the auction may not be completed and the ARS then pays a default interest rate. Following such a failed auction, we cannot access our funds that are invested in the corresponding ARS until a future auction of these investments is successful, new buyers express interest in purchasing these securities in between reset dates, issuers establish a different form of financing to replace these securities or final payments become due according to contractual maturities. Commencing in February 2008, conditions in the global credit markets resulted in failed auctions for all of the ARS we held. In the near term, our ability to liquidate our investments in ARS or fully recover the carrying values may be limited or not exist.

In October 2008, UBS extended an offer to us to sell our eligible ARS at par value back to UBS beginning June 30, 2010 through July 2, 2012. We believe that all of the UBS ARS we hold qualify as eligible for purposes of the UBS rights offer. In November 2008, we elected to accept the offer from UBS, which gave us the option to sell back to UBS a total of $20.2 million of our ARS at par value at any time from June 30, 2010 through July 2, 2012. Upon our acceptance of the UBS rights offer, we elected to value the ARS put option at fair value. Because we have accepted the UBS offer, we have elected to record a one-time transfer of our UBS ARS from available-for-sale to trading securities on our balance sheet. The transfer from available-for-sale to trading securities on our balance sheet reflects management s intent to exercise its ARS put option during the period June 30, 2010 to July 2, 2012. On June 30, 2010, we exercised our rights under the Rights Agreement with UBS. Of the $20.2 million at par we held immediately prior to exercising the put, $11.1 was settled on June 30,2010 while the remaining $9.1 million was settled on July 1, 2010.

Given the exercise of our rights under the Rights Agreement on June 30, 2010, guaranteeing the company redemption of the UBS ARS at par value, the fair value of our UBS ARS holdings was valued at par at June 30, 2010. Fair value for non-UBS ARS, classified as available-for-sale, was based on a discounted cash flow valuation that takes into account a number of factors including the WART of the underlying securities, the expected return, and the discount rate. The actual WART from servicing reports was used where available. For securities where the actual WART was not available an estimate based on other securities held was used. The expected return was calculated based on the last twelve months average for the 91 day U.S. treasury bill plus a spread. This rate is the typical default rate for ARS held by us. The discount rate was calculated using the 3-month LIBOR rate plus adjustments for the security type. Changes in any of the above estimates, especially the WART or the discount rate, could result in a material change to the fair value. At June 30, 2010, all non-UBS ARS were classified as Level 3 assets. Presently we have determined the decline in value for the available-for-sale ARS to be temporary because i) we have no current intent to sell the security, and we believe that we will not be required to sell the security before the recovery of its amortized cost due to our large cash reserves; ii) through June 30, 2010 all of the securities have maintained AAA credit ratings; and iii) loans made by the issuers are backed by the federal government. We also conclude that we do not intend to sell an impaired available-for-sale security and will not be required to sell such a security before the recovery of our amortized cost basis due to its large cash reserves.

However, if circumstances change, we may be required to record an other-than-temporary impairment charge on the available-for-sale ARS. We may similarly be required to record other-than-temporary impairment charges if the ratings on any of these securities are reduced or if any of the issuers default on their obligations. In addition to impairment charges, any of these events could cause us to lose part or all of our investment in these securities. As of June 30, 2010, we had investments in ARS with estimated fair values of $12.1 million. Any of these events could materially affect our results of operations and our financial condition. We currently believe these securities are not significantly impaired for the reasons described above; however, it could take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

Impact of Foreign Currency Rate Changes

The functional currencies of our international operating subsidiaries are the local currencies. We translate the assets and liabilities of our foreign subsidiaries at the exchange rates in effect on the balance sheet date. We translate their income and expenses at the average rates of exchange in effect during the period. We include translation gains and losses in the stockholders equity section of our balance sheet. We include net gains and losses resulting from foreign exchange transactions in interest income and other in our statements of operations. Since we translate foreign currencies (primarily Canadian dollars, British Pound Sterling, Australia dollars, and Indian rupees) into U.S. dollars for financial reporting purposes, currency fluctuations may have a material impact on our financial results. We have both revenue and expenses that are denominated in foreign currencies. Foreign currency expenses are generally larger than foreign currency revenue. A weaker U.S. dollar environment would generally have a negative impact on our statement of operations, while a stronger U.S. dollar environment would have a positive impact on our statement of operations. The historical impact of currency fluctuations has generally been immaterial. As of June 30, 2010 we did not engage in foreign currency hedging activities.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet, and our management believes they meet, reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 5 Contingencies to the condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of legal proceedings.

ITEM 1A. RISK FACTORS

This report contains forward-looking statements regarding our business and expected future performance as well as assumptions underlying or relating to such statements of expectation, all of which are forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We are subject to many risks and uncertainties that may materially affect our business and future performance and cause those forward-looking statements to be inaccurate. Words such as expects, anticipates, intends, plans, believes, forecasts, estimates, seeks, may result in, focused on, continue to, and similar expressions often identify forward-looking stat this report, forward-looking statements include, without limitation, the following:

Our expectations and beliefs regarding future financial results, conduct and growth of our business;

Our expectations regarding channel partners and the anticipated timing and magnitude of revenue from these partners;

Our expectations regarding sales of the Sammsoft software products we acquired in the fourth quarter of 2009 and our ability to develop, market and sell these products and to source, develop and distribute additional software products and integrate such products into our business;

Our expectations regarding our ability to deliver premium technology services efficiently;

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- Our ability to hire, train, manage and retain personal technology experts in a home-based model;
- Our ability to match staffing levels with service volume;
- Our beliefs and expectations regarding the introduction of new services and products;
- Our beliefs and expectations regarding new business opportunities and renewals of existing relationships;
- Our expectations regarding revenues, cash flows and expenses, including cost of goods sold, sales and marketing, research and development efforts, and administrative expenses;
- Our assessment of seasonality, mix of revenue, and other trends for our business;
- Our expectations regarding the costs and other effects of acquisition and disposition transactions;
- Our expectations regarding unit volumes, pricing and other factors in the PC market and the effects of such factors on our business;
- Our beliefs regarding the impact of global economic instability on our business;
- The assumptions underlying our Critical Accounting Policies and Estimates, including our assumptions regarding revenue recognition; assumptions used to estimate the fair value of share-based compensation; assumptions regarding the impairment of goodwill and intangible assets; and expected accounting for income taxes; and
- The expected effects of the adoption of new accounting standards.

An investment in our stock involves risk, and we caution investors that forward-looking statements are only predictions based on our current expectations about future events and are not guarantees of future performance. We encourage you to read carefully all information provided in this report and in our other filings with the SEC before deciding to invest in our stock or to maintain or change your investment. Forward-looking statements are based on information as of the filing date of this report, and we undertake no obligation to publicly revise or update any forward-looking statement for any reason.

Because forward-looking statements involve risks and uncertainties, there are important factors that may cause actual results to differ materially from our stated expectations. These factors are described below. This list does not include all risks that could affect our business, and if these or any other risks or uncertainties materialize, or if our underlying assumptions prove to be inaccurate, actual results could differ materially from past results and from our expected future results.

Our business has not been profitable and may not achieve profitability in future periods.

We have not been profitable since 2005. We intend to make significant investments in support of our business, and we expect to continue to sustain losses in 2010. If we fail to achieve revenue growth as a result of these additional investments or if such revenue growth does not result in our achieving profitability, the market price of our common stock will likely decline. We expect to continue to consume cash until we reach higher revenue levels. A sustained period of losses would result in an increased usage of cash to fund our operating activities and a corresponding reduction in our cash balance.

Our business has a limited operating history and is based on a relatively new business model.

Our Consumer business is a technology-enabled services business launched in 2007 to provide services and software that help consumers and small businesses with their technology needs. Prior to 2007, we operated only our Enterprise business, which we sold in the second quarter of 2009. We are executing a plan to grow our business by providing premium technology services to consumers both through channel partners and directly. We may not be able to offer these services successfully. All of our Personal Technology Experts are home-based, which requires a high degree of coordination and quality control of employees working from diverse and remote locations. We are currently experiencing financial losses in our business and we expect to continue to use significant cash and incur significant costs to support this initiative. These investments, which typically are made in advance of revenue, may not yield increased revenue to offset these expenses. As a result of these factors, the future revenue and income potential of our business is uncertain. Any evaluation of our business and our prospects must be considered in light of these factors and the risks and uncertainties often encountered by companies in our early stage of development. Some of these risks and uncertainties relate to our ability to do the following:

- Maintain our current relationships, and develop new relationships, with channel partners and consumers on acceptable terms or at all;

- Reach consumers directly in a cost-effective fashion;
- Hire, train, manage and retain our home-based personal technology experts;
- Meet anticipated growth targets;
- Manage our business to provide services on an efficient basis in order to achieve profitability;
- Successfully introduce new, and adapt our existing, services and products for consumers;
- Respond effectively to competition;
- Adapt to industry consolidation;
- Respond to government regulations relating to our business;
- Attract and retain qualified management and employees; and
- Manage our expanding operations and implement and improve our operational, financial and management controls.

If we are unable to address these risks, our business, results of operations and prospects could suffer.

Our quarterly results have in the past, and may in the future, fluctuate significantly.

Our quarterly revenue and operating results have in the past and may in the future fluctuate from quarter to quarter. As a result, we believe that quarter-to-quarter and year-to-year comparisons of our revenue and operating results may not be accurate indicators of future performance.

Several factors that have contributed or may in the future contribute to fluctuations in our operating results include:

- Demand for our services and products;
- Our ability to increase the efficiency and capacity of our service delivery organization;
- The performance of our channel partners;
- Our ability to effectively match staffing levels with service volumes;

Our reliance on a small number of channel partners for a substantial portion of our revenue;

Our ability to attract and retain customers and channel partners;

The rate of expansion of our offerings and our investments therein;

The price and mix of products and services we or our competitors offer;

Changes in the PC market relating to unit volume, pricing and other factors and the effects of such changes on our business;

Instability in the global macroeconomic climate and its effect on our and our channel partners operations;

Our ability to adapt to our customers needs in a market space defined by frequent technological change;

Seasonal trends resulting from consumer spending patterns;

The amount and timing of operating costs and capital expenditures in our business;

Diversion of management s attention from other business concerns and disruption of our ongoing business as a result of acquisitions or divestitures by us;

Potential losses on investments, or other losses from financial instruments we may hold that are exposed to market risk; and

The exercise of judgment by our management in making accounting decisions in accordance with our accounting policies.

Our inability to meet future financial performance targets that we announce or that are published by research analysts could cause the market price of our common stock to decline.

From time to time, we provide guidance related to our future financial performance. In addition, financial analysts may publish their own expectations of our future financial performance. Because our quarterly revenue and our operating results fluctuate and are difficult to predict, future financial performance is difficult to predict. In the past, including in the second quarter of 2010, we have failed to meet our guidance and our stock price has declined. Generally, the market prices of technology companies have been extremely volatile. Stock prices of many technology companies have often fluctuated in a manner unrelated or disproportionate to the operating performance of such companies. In the past, following periods of market volatility, stockholders have often initiated securities class action litigation relating to the stock trading and price volatility of the technology company in question. Any securities litigation we may become involved in could result in our incurring substantial defense costs and diverting resources and the attention of management from our business.

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Our Enterprise business historically generated a substantial portion of our revenue. After its sale we are a smaller company, and in order to succeed, we will need to achieve profitability in our Consumer business.

In June 2009, we sold our Enterprise business, which has historically been the source of a substantial portion of our revenue. For the fiscal year ended December 31, 2009, revenue from our continuing operations was $17.5 million. In order to succeed, we will need to achieve profitability in our Consumer business. Given that the sole focus of our business is now our Consumer operations, expectations from stockholders and analysts that we produce improved financial results for our Consumer business are heightened as compared to the periods prior to the sale of the Enterprise business, when the diversity of our revenue streams could enable one of our segments to offset weakness in the other segment.

Because a small number of customers and channel partners have historically accounted for and may in future periods account for the substantial majority of our revenue, delays of specific programs or losses of certain customers could decrease our revenue substantially.

In 2009, one customer, Office Depot, accounted for the substantial majority of our total revenue after giving effect to the sale of our Enterprise business. Although we are implementing and expanding programs with several other channel partners as well as growing our software business, Office Depot will, at least in the near term, account for a significant portion of our total revenue. Over the course of 2009, the percentage of revenue attributable to Office Depot has decreased each quarter. We expect the percent of revenue attributable to Office Depot to decline further in 2010 as we expand our service channel partnerships and grow our software business. Our agreement with Office Depot has a limited initial term and provides for a renewal period if agreed to by the parties. This agreement may not be renewed on acceptable terms or at all. Even if the agreement continues to be renewed, however, it does not require Office Depot to do any minimum amount of business with us, and therefore Office Depot could decide at any time to reduce or eliminate its use of our services. Our revenue could decline significantly because of the loss or decline in activity of Office Depot or the delay or loss of a significant program by other channel partners. Additionally, we may not obtain new channel partners or customers. The failure to obtain significant new channel partners or the loss or decline of significant channel partners would have a material adverse effect on our operating results. Further risks associated with the loss or decline in a significant channel partner are detailed in Our failure to establish and expand successful partnerships to sell our services and products would harm our operating results below.

Our failure to establish and expand successful partnerships to sell our services and products would harm our operating results.

Our current business model requires us to establish and maintain relationships with third parties who market and sell our services and products. Failure to establish or maintain third-party relationships in our business, particularly with firms that sell our services and products, could materially and adversely affect the success of our business. We sell to numerous consumers through each of these channel partners, and therefore a delay in the launch or rollout of our services with even one of these channel partners could cause us to miss revenue targets. The process of establishing a relationship with a channel partner can be complex and time consuming, and we must pass multiple levels of review in order to be selected. If we are unable to establish a sufficient number of new channel partners on a timely basis our sales will suffer. There is also the risk that, once established, our programs with these channel partners may take longer than we expect to produce revenue or may not produce revenue at all. One or more of our key channel partners, including Office Depot, may also discontinue selling our services, offer them only on a limited basis or devote insufficient time and attention to promoting them to their customers. Some of our partners may prefer not to work with us if we also partner with their competitors. If any of these key channel partners merge with a competitor, all of these risks could be exacerbated. Each of these risks could reduce our sales and significantly harm our operating results.

If we fail to hire, train and manage our Personal Technology Experts in a manner that provides an adequate level of support for our customers, our reputation and financial performance could be harmed.

Our business depends in part on our ability to attract, manage and retain our Personal Technology Experts in order to satisfy demand for our services. If we are unable to hire, train and manage adequate numbers of competent Personal Technology Experts, our service levels could decline, which could harm our reputation, cause us to lose customers and channel partners and adversely affect our financial performance. Although our service delivery and communications infrastructure enables us to monitor and manage these Personal Technology Experts remotely, because they are home-based and geographically dispersed, we could experience difficulties meeting services levels. In addition, any problems we encounter retaining Personal Technology Experts could seriously jeopardize our service delivery operations and our revenue.

From time to time, we enter into relationships with third parties to provide on-site services for certain customers. We may be less able to manage the quality of services provided by third-party onsite service providers as directly as we would our own employees. In addition, providing these services may be more costly. We also face the risk that disruptions or delays in these third parties communications and information technology infrastructure could cause lengthy interruptions in the availability of our services. Any of these risks could harm our operating results.

Disruptions in our information technology and service delivery infrastructure and operations, including interruptions or delays in service from our third-party web hosting provider, could impair the delivery of our services and harm our business.

We depend on the continuing operation of our information technology and communication systems and those of our external service providers. Any damage to or failure of those systems could result in interruptions in our service, which could reduce our revenues and damage our reputation. The technology we use to serve customers is hosted at a third-party facility located in the United States. This facility is operated by a publicly held company specializing in operating such facilities, and we do not control the operation of this facility. As it briefly did last year, this facility may experience unplanned outages and other technical difficulties, and it is vulnerable to damage or interruption from fires, floods, earthquakes, telecommunications and connectivity failures, power failures, and similar events. This facility is also subject to risks from vandalism, break-ins, intrusion, and other malicious attacks. Despite substantial precautions taken, such as disaster recovery planning and back-up procedures, a natural disaster, act of terrorism or other unanticipated problem could cause a loss of information and data and lengthy interruptions in the availability of our services and hosted solutions offerings, as our backup systems may not be able to meet our needs for an extended period of time. We rely on hosted systems maintained by third-party providers to deliver technology services to consumers, including taking customer orders, handling telecommunications for customer calls, and tracking sales and service delivery. Any interruption or failure of our internal or external systems could prevent us or our service providers from accepting orders and delivering services, or cause company and consumer data to be unintentionally disclosed. Our continuing efforts to upgrade and enhance the security and reliability of our information technology and communications infrastructure could be very costly, and we may have to expend significant resources to remedy problems such as a security breach or service interruption. Interruptions in our services resulting from labor disputes, telephone or internet failures, power or service outages, natural disasters or other events, or a security breach could reduce our revenue, increase our costs, cause customers and channel partners to fail to renew or to terminate their use of our offerings, and harm our reputation and our ability to attract new customers.

Changes to the cost of online advertising may negatively impact our ability to acquire customers.

Our software revenue stream is highly dependent on obtaining advertising placements in a cost-effective manner. Periodically a disruptive trend will impact the online advertising space, significantly increasing the cost of online advertising and therefore compromising our ability to purchase advertisements. If such a trend were to occur, our costs for advertising may increase beyond our forecasts, and our operating results would be negatively impacted.

We must compete successfully in the markets in which we operate or our business will suffer.

We compete in markets that are highly competitive, subject to rapid change and significantly affected by new service introductions and other market activities of industry participants. We compete with a number of companies in the market for online technology services and software products. In addition, our channel partners may develop similar offerings internally.

The markets for our services and software products are still rapidly evolving, and we may not be able to compete successfully against current and potential competitors. Our ability to expand our business will depend on our ability to maintain our technological advantage, introduce timely enhanced products to meet growing support needs, deliver on-going value to our customers and scale our business. Competition in our markets could reduce our market share or require us to reduce the price of products and services, which could harm our business, financial condition and operating results.

The competitors in our markets for services and software can have some or all of the following comparative advantages: longer operating histories; greater economies of scale; greater financial resources; greater engineering and technical resources; greater sales and marketing resources; stronger strategic alliances and distribution channels; lower labor costs; products with different functions and feature sets; and greater brand recognition than we have. We expect new competitors to continue to enter our services market given its relatively early stage, and we expect our software market to remain competitive.

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Our future service and product offerings may not achieve market acceptance.

If we fail to develop enhanced versions of our services and products in a timely manner or to provide services and products that achieve rapid and broad market acceptance, we may not maintain or expand our market share. We may fail to identify new service and product opportunities for our current market or new markets that we enter in the future. In addition, our existing services and products may become obsolete if we fail to introduce new services and products that meet new customer demands or support new standards. While we are developing new services and products, there can be no assurance that they will gain market acceptance or generate material revenue for us. We have limited control over factors that affect market acceptance of our services and products, including the willingness of channel partners to offer our services and products and customer preferences for competitors services, products and delivery models. We rely on a third party to develop certain of the Sammsoft software products we acquired in the fourth quarter of 2009. If our relationship with that third party were to deteriorate, or if the third parties were unable to develop innovative and saleable products, we could be forced to identify a new developer and our future revenue could suffer.

We may make acquisitions that may not prove successful.

We have made acquisitions in the past and may make additional acquisitions in the future. We may not be able to identify suitable acquisition candidates at prices we consider appropriate. If we do identify an appropriate acquisition candidate, we may not be able to successfully negotiate the terms of the acquisition. Our management may not be able to effectively implement our acquisition program and internal growth strategy simultaneously. The integration of acquisitions involves a number of risks and presents financial, managerial and operational challenges. We may have difficulty, and may incur unanticipated expenses related to, integrating management and personnel from these acquired entities with our management and personnel. Our failure to identify, consummate or integrate suitable acquisitions could adversely affect our business and results of operations. We cannot readily predict the timing, size or success of our future acquisitions. Even successful acquisitions could have the effect of reducing our cash balances. Acquisitions and divestitures could involve a number of other potential risks to our business, including the following, any of which could harm our business results:

- Unanticipated costs and liabilities and unforeseen accounting charges or fluctuations;
- Delays and difficulties in delivery of services and products;
- Failure to effectively integrate or separate management information systems, personnel, research and development, marketing, sales and support operations;
- Loss of key employees;
- Economic dilution to gross and operating profit;
- Diversion of management s attention from other business concerns and disruption of our ongoing business;
- Difficulty in maintaining controls and procedures;
- Uncertainty on the part of our existing customers about our ability to operate after a transaction;
- Loss of customers;

- Loss of partnerships;
- Declines in revenue and increases in losses;
- Failure to realize the potential financial or strategic benefits of the acquisition or divestiture; and
- Failure to successfully further develop the combined or remaining technology, resulting in the impairment of amounts recorded as goodwill or other intangible assets.

Our systems collect, access, use, and store personal customer information and enable customer transactions, which poses security risks, requires us to invest significant resources to prevent or correct problems caused by security breaches, and may harm our business.

A fundamental requirement for online communications, transactions and support is the secure collection, storage and transmission of confidential information. Our systems collect and store confidential and/or personal information of our individual customers as well as our channel partners and their customers users, including credit card information, and our employees and contractors may access and use that information in the course of providing services. In addition, we collect and retain personal information of our employees in the ordinary course of our business. We and our third-party contractors use commercially available technologies to secure this information. Despite these measures, third parties may attempt to breach the security of our data or that of our customers. In addition, errors in the storage or transmission of data could breach the security of that information. We may be liable to our customers for any breach in security and any breach could subject us to governmental or administrative proceedings or monetary penalties, damage our relationships with channel partners and harm our business and reputation. Also, computers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We may be required to expend significant capital and other resources to comply with mandatory privacy and security standards required by law, industry standard, or contract, and to further protect against security breaches or to correct problems caused by any security breach.

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We are exposed to risks associated with credit card and payment fraud and with credit card processing.

Certain of our customers use credit cards to pay for our services and products. We may suffer losses as a result of orders placed with fraudulent credit cards or other payment data. Our failure to detect or control payment fraud could have an adverse effect on our results of operations. We are also subject to payment card association operating standards and requirements, as in effect from time to time. Compliance with those standards requires us to invest in network and systems infrastructure and processes. Failure to comply with these rules or requirements may subject us to fines, potential contractual liabilities, and other costs, resulting in harm to our business and results of operations.

Privacy concerns and laws or other domestic or foreign regulations may require us to incur significant costs and may reduce the effectiveness of our solutions, and our failure to comply with those laws or regulations may harm our business and cause us to lose customers.

Our software contains features that allow our personal technology experts to access, control, monitor or collect information from computers running our software. Federal, state and foreign government bodies and agencies, however, have adopted or are considering adopting laws and regulations restricting or otherwise regulating the collection, use and disclosure of personal information obtained from consumers and individuals. Those regulations could require costly compliance measures, could reduce the efficiency of our operations, or could require us to modify or cease to provide our systems or services. Liability for violation of, costs of compliance with, and other burdens imposed by such laws and regulations may limit the use and adoption of our services and reduce overall demand for them. Even the perception of privacy concerns, whether or not valid, may harm our reputation and inhibit adoption of our solutions by current and future customers. In addition, we may face claims about invasion of privacy or inappropriate disclosure, use, storage, or loss of information obtained from our customers. Any imposition of liability could harm our reputation, cause us to lose customers and cause our operating results to suffer.

We rely on third-party technologies in providing certain of our services and software. Our inability to use, retain or integrate third-party technologies and relationships could delay service or software development and could harm our business.

We license technologies from third parties which are integrated into our services and software. We rely on a third party to develop certain of the Sammsoft software products we acquired in the fourth quarter of 2009. Our use of technologies licensed on a non-exclusive basis from third parties, including the developer of certain of the Sammsoft products, poses certain risks. Some of the third-party technologies we license may be provided under open source licenses, which may have terms that require us to make generally available our modifications or derivative works based on such open source code. Our inability to obtain or integrate third-party technologies with our own technology could delay service development until equivalent compatible technology can be identified, licensed and integrated. These third-party technologies may not continue to be available to us on commercially reasonable terms or at all. If our relationship with third parties were to deteriorate, or if such third parties were unable to develop innovative and saleable products, we could be forced to identify a new developer and our future revenue could suffer. We may fail to successfully integrate any licensed technology into our services or software, or maintain it through our own development work, which would harm our business and operating results. Third-party licenses also expose us to increased risks that include:

- Risks of product malfunction after new technology is integrated;
- Risks that we may be unable to obtain or continue to obtain support, maintenance and updates from the technology supplier;
- The diversion of resources from the development of our own proprietary technology; and
- Our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs.

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We rely upon intellectual property laws to protect our proprietary rights, and if these rights are not sufficiently protected or we are not able to obtain sufficient protection for our technology, it could harm our ability to compete and to generate revenue.

We rely on a combination of laws, such as those applicable to patents, copyrights, trademarks and trade secrets, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. Our ability to compete and grow our business could suffer if these rights are not adequately protected. Our proprietary rights may not be adequately protected because:

- Laws and contractual restrictions may not adequately prevent infringement of our proprietary rights and misappropriation of our technologies or deter others from developing similar technologies; and
- Policing infringement of our patents, trademarks and copyrights, misappropriation of our trade secrets, and unauthorized use of our products is difficult, expensive and time-consuming, and we may be unable to determine the existence or extent of this infringement or unauthorized use.

Intellectual property litigation is expensive and time-consuming and could divert management s attention from our business. The outcome of any litigation is uncertain and could significantly impact our financial results. Also, the laws of other countries in which we market our products may offer little or no protection of our proprietary technologies. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for them, which would harm our competitive position and market share.

Our success and ability to compete depend to a significant degree upon the protection of our solutions and other proprietary technology. It is possible that:

- We may not be issued patents we may seek to protect our technology;
- Competitors may independently develop similar technologies or design around any of our patents;
- Patents issued to us may not be broad enough to protect our proprietary rights; and
- Our issued patents could be successfully challenged.

We may face intellectual property infringement claims that could be costly to defend and result in our loss of significant rights.

Our business relies upon the use and licensing of technology. Other parties may assert intellectual property infringement claims against us or our customers, and our products may infringe the intellectual property rights of third parties. For example, our products may infringe patents issued to third parties. In addition, as is increasingly common in the technology sector, we may be confronted with the aggressive enforcement of patents by companies whose primary business activity is to acquire patents for the purpose of offensively asserting them against other companies. From time to time, we have received allegations of intellectual property infringement, and we may receive more claims in the future. We may also be required to pursue litigation to protect our intellectual property rights. Intellectual property litigation is expensive and time-consuming and could divert management s attention from our business. The outcome of any litigation is uncertain and could significantly impact our financial results. If there is a successful claim of infringement, we may be required to develop non-infringing technology or enter into royalty or license agreements, which may not be available on acceptable terms, if at all. Our failure to develop non-infringing technologies or license proprietary rights on a timely basis would harm our business.

Changes in the market for PCs and other electronic products could adversely affect our business.

Reductions in unit volumes of PCs or other devices sold, or in the prices of such devices, could adversely affect our business. We offer both services that are attached to the sales of new PCs and other devices and services designed to fix existing PCs and other devices. Declines in the unit volumes sold of these devices or declines in the pricing of such devices could adversely affect demand for our services and/or our revenue mix, either of which would harm our operating results.

We are a small public company with a large cash balance relative to our size.

We are a publicly traded company and are subject to SEC and Nasdaq rules and regulations, including the Sarbanes-Oxley Act of 2002. While all public companies face the costs and burdens associated with being publicly traded, given the size of our business, the costs and burden of being a public company will be material. We had approximately $79.0 million in cash, cash equivalents and investments as of June 30, 2010. In the past our market capitalization has been lower than our cash balance. If that were to occur again, we may be a take-over target in the future. This might cause distractions for our management and our board of directors and might otherwise prevent us from executing on our strategy for the business to build long term stockholder value.

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The Asset Purchase Agreement for our Enterprise business may expose us to contingent liabilities.

Under the Asset Purchase Agreement we entered into with Consona Corporation (Consona) in connection with the sale of our Enterprise business completed in June 2009, we agreed to indemnify Consona for breaches or violations of any representation, warranty, covenant or agreement made by us in the Asset Purchase Agreement, for pre-closing and other liabilities related to the Enterprise business, and for other matters, subject to certain limitations. Significant indemnification claims by Consona could have a material adverse effect on our financial condition.

We have recorded long-lived assets, and our results of operations would be adversely affected if their value becomes impaired.

Goodwill and identifiable intangible assets were recorded in part due to our acquisition of substantially all of the assets and liabilities of YourTechOnline.com (YTO) in May 2008 and our acquisition of substantially all of the assets of Xeriton in December 2009. We also have certain intangible assets with indefinite lives. We assess the impairment of goodwill and indefinite lived intangible assets annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. We assess the impairment of acquired product rights and other finite lived intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. Our results of operations would be adversely affected if impairment of our goodwill or intangible assets occurred.

Economic instability may harm our operating results and the financial condition of our business.

As has been widely reported, over the past two years the global economy has been experiencing extreme disruption, including, among other things, higher mortgage delinquencies, increased unemployment, decreased consumer spending, highly volatile securities markets, diminished liquidity and credit availability, currency fluctuation and downgrades and declining valuations of certain investments. These economic developments potentially affect our business in several ways. Consumers may be less willing to pay for our services, including seasonal periods in which we have typically experienced growth such as the Back to School period in the third quarter. In addition, our channel partners and prospects may be unable to obtain financing for major commitments and operations, they may reduce their spending or delay or cancel programs that include our offerings and they may be unable to pay us in a timely fashion or at all. While we monitor these situations carefully and attempt to take appropriate measures to protect ourselves by recognizing revenue upon collection of accounts from channel partners we deem to have credit risks and upon sell-through by resellers, it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs would negatively affect our operating results for the period in which they occur and, if large enough, could have a material adverse effect on our operating results and financial condition. Our business, including our investment portfolio, may be harmed by general decreases in economic activity, including decreases in business and consumer spending and uncertainty due to economic disruptions and government intervention in the financial markets. We cannot predict the duration and severity of the current disruption in the macroeconomic climate and market conditions, and these conditions may harm our operating results.

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ITEM 6. EXHIBITS

Exhibits.

31.1	Chief Executive Officer Section 302 Certification
31.2	Chief Financial Officer Section 302 Certification
32.1	Statement of the Chief Executive Officer under 18 U.S.C. § 1350(1)
32.2	Statement of the Chief Financial Officer under 18 U.S.C. § 1350(1)

(1) The certifications filed as Exhibits 32.1 and 32.2 are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of the Company under the Securities Exchange Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof irrespective of any general incorporation by reference language contained in any such filing, except to the extent that the registrant specifically incorporates it by reference.

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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.

August 6, 2010	SUPPORT.COM, INC.
	By: /s/ SHELLY SCHAFFER
	Shelly Schaffer
	Chief Financial Officer and Executive Vice President of Finance and Administration

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EXHIBIT INDEX TO SUPPORT.COM, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2010

31.1	Chief Executive Officer Section 302 Certification
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As of September 30, 2014

Allowance for credit losses:

Individually evaluated for impairment

$4,409 $578 $1,330 $- $1,478 $218 $- $8,013

Collectively evaluated for impairment

8,764 10,623 1,985 980 13,158 1,144 287 36,941

Ending balance

$13,173 $11,201 $3,315 $980 $14,636 $1,362 $287 $44,954

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The Company’s recorded investments in loans as of September 30, 2015, December 31, 2014 and September 30, 2014 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company’s impairment methodology was as follows:

(dollars in thousands)	Commercial	Income Producing Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
September 30, 2015								
Recorded investment in loans:								
Individually evaluated for impairment	$ 12,869	$ 6,877	$ 1,790	$ -	$ 17,644	$ 661	$ 72	$ 39,913
Collectively evaluated for impairment	994,790	2,016,073	487,867	147,720	970,108	114,685	5,809	4,737,052
Ending balance	$ 1,007,659	$ 2,022,950	$ 489,657	$ 147,720	$ 987,752	$ 115,346	$ 5,881	$ 4,776,965
December 31, 2014								
Recorded investment in loans:								
Individually evaluated for impairment	$ 17,612	$ 5,109	$ 6,891	$ -	$ 14,241	$ 1,398	$ 59	$ 45,310
Collectively evaluated for impairment	898,614	1,698,063	454,690	148,018	837,223	121,138	109,343	4,267,089
Ending balance	$ 916,226	$ 1,703,172	$ 461,581	$ 148,018	$ 851,464	$ 122,536	$ 109,402	$ 4,312,399
September 30, 2014								
Recorded investment in loans:								
Individually evaluated for impairment	$ 17,785	$ 2,710	$ 5,054	$ -	$ 17,479	$ 745	$ -	$ 43,773

Collectively evaluated for impairment	780,704	1,380,129	332,368	126,263	659,103	106,546	3,662	3,388,775
Ending balance	$798,489	$1,382,839	$337,422	$126,263	$676,582	$107,291	$3,662	$3,432,548

At September 30, 2015, nonperforming loans acquired have a carrying value of $1.8 million and an unpaid principal balance of $2.9 million and were evaluated separately in accordance with ASC Topic 310-30, *"Loans and Debt Securities Acquired with Deteriorated Credit Quality*." The various impaired loans were recorded at estimated fair value with any excess being charged-off or treated as a non-accretable discount. Subsequent downward adjustments to the valuation of impaired loans acquired will result in additional loan loss provisions and related allowance for credit losses. Subsequent upward adjustments to the valuation of impaired loans acquired will result in accretable discount. No adjustments have been made to the fair value amounts of impaired loans subsequent to the allowable period of adjustment from the date of acquisition.

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Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans into pass, watch, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company's credit quality indicators:

Pass:	Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
Watch:	Loan paying as agreed with generally acceptable asset quality; however the obligor's performance has not met expectations. Balance sheet and/or income statement has shown deterioration to the point that the obligor could not sustain any further setbacks. Credit is expected to be strengthened through improved obligor performance and/or additional collateral within a reasonable period of time.
Special Mention:	Loans in the classes that comprise the commercial portfolio segment that have potential weaknesses that deserve management's close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan. The special mention credit quality indicator is not used for classes of loans that comprise the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans that are considered special mention.
Classified:	Classified (a) Substandard - Loans inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Classified (b) Doubtful - Loans that have all the weaknesses inherent in a loan classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

The Company's credit quality indicators are updated generally on a quarterly basis, but no less frequently than annually. The following table presents by class and by credit quality indicator, the recorded investment in the Company's loans and leases as of September 30, 2015, December 31, 2014 and September 30, 2014.

(dollars in thousands)	**Pass**	**Watch and Special Mention**	**Substandard**	**Doubtful**	**Total Loans**
September 30, 2015					
Commercial	$977,165	$ 17,625	$ 12,869	$ -	$1,007,659
Income producing - commercial real estate	1,999,509	16,564	6,877	-	2,022,950
Owner occupied - commercial real estate	479,843	8,024	1,790	-	489,657
Real estate mortgage – residential	146,992	728	-	-	147,720
Construction - commercial and residential	964,854	5,254	17,644	-	987,752
Home equity	112,978	1,707	661	-	115,346
Other consumer	5,804	5	72	-	5,881
Total	$4,687,145	$ 49,907	$ 39,913	$ -	$4,776,965
December 31, 2014					
Commercial	$875,102	$ 23,512	$ 17,612	$ -	$916,226
Income producing - commercial real estate	1,679,101	18,962	5,109	-	1,703,172
Owner occupied - commercial real estate	445,013	9,677	6,891	-	461,581
Real estate mortgage – residential	147,262	756	-	-	148,018
Construction - commercial and residential	827,503	9,720	14,241	-	851,464
Home equity	119,420	1,718	1,398	-	122,536
Other consumer	109,343	-	59	-	109,402
Total	$4,202,744	$ 64,345	$ 45,310	$ -	$4,312,399
September 30, 2014					
Commercial	$761,502	$ 19,202	$ 17,785	$ -	$798,489
Investment - commercial real estate	1,362,060	18,069	2,710	-	1,382,839
Owner occupied - commercial real estate	320,960	11,408	5,054	-	337,422
Real estate mortgage – residential	125,363	900	-	-	126,263
Construction - commercial and residential	650,679	8,424	17,479	-	676,582
Home equity	104,601	1,945	745	-	107,291
Other consumer	3,662	-	-	-	3,662
Total	$3,328,827	$ 59,948	$ 43,773	$ -	$3,432,548

Nonaccrual and Past Due Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following table presents, by class of loan, information related to nonaccrual loans as of the periods ended September 30, 2015, December 31, 2014 and September 30, 2014.

(dollars in thousands)	**September 30, 2015**	**December 31, 2014**	**September 30, 2014**
Commercial	$ 4,828	$ 12,975	$ 15,431
Income producing - commercial real estate	6,721	2,645	2,553
Owner occupied - commercial real estate	1,281	1,324	3,502
Real estate mortgage - residential	333	346	350
Construction - commercial and residential	571	3,697	6,919
Home equity	661	1,398	588
Other consumer	72	58	-
Total nonaccrual loans (1)(2)	$ 14,467	$ 22,443	$ 29,343

(1) Excludes troubled debt restructurings ("TDRs") that were performing under their restructured terms totaling $15.2 million at September 30, 2015, $13.5 million at December 31, 2014 and $7.9 million at September 30, 2014.

(2) Gross interest income of $822 thousand would have been recorded for the nine months ended September 30, 2015 if nonaccrual loans shown above had been current and in accordance with their original terms, while interest actually recorded on such loans was $127 thousand. See Note 1 to the consolidated financial statements for a description of the Company's policy for placing loans on nonaccrual status.

The following table presents, by class of loan, an aging analysis and the recorded investments in loans past due as of September 30, 2015 and December 31, 2014.

(dollars in thousands)	**Loans 30-59 Days Past Due**	**Loans 60-89 Days Past Due**	**Loans 90 Days or More Past Due**	**Total Past Due Loans**	**Current Loans**	**Total Recorded Investment in Loans**
September 30, 2015						
Commercial	$731	$2,537	$4,828	$8,096	$999,563	$1,007,659
Income producing - commercial real estate	-	5,058	6,721	11,779	2,011,171	2,022,950
Owner occupied - commercial real estate	319	-	1,281	1,600	488,057	489,657
Real estate mortgage – residential	-	-	333	333	147,387	147,720
Construction - commercial and residential	157	5,037	571	5,765	981,987	987,752

Home equity	173	641	661	1,475	113,871	115,346
Other consumer	54	8	72	134	5,747	5,881
Total	$1,434	$13,281	$14,467	$29,182	$4,747,783	$4,776,965
December 31, 2014						
Commercial	$1,505	$4,032	$12,975	$18,512	$897,714	$916,226
Income producing - commercial real estate	1,825	5,376	2,645	9,846	1,693,326	1,703,172
Owner occupied - commercial real estate	1,089	214	1,324	2,627	458,954	461,581
Real estate mortgage – residential	-	-	346	346	147,672	148,018
Construction - commercial and residential	-	-	3,697	3,697	847,767	851,464
Home equity	-	1,365	1,398	2,763	119,773	122,536
Other consumer	284	81	58	423	108,979	109,402
Total	$4,703	$11,068	$22,443	$38,214	$4,274,185	$4,312,399

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Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged-off when deemed uncollectible.

The following table presents, by class of loan, information related to impaired loans for the periods ended September 30, 2015, December 31, 2014 and September 30, 2014.

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment Quarter To Date	Average Recorded Investment Year To Date	Interest Income Recognized Quarter To Date	Interest Income Recognized Year To Date
September 30, 2015									
Commercial	$ 9,444	$ 2,663	$ 3,337	$ 6,000	$ 2,312	$7,978	$10,047	$39	$48
Income producing - commercial real estate	15,925	9,215	6,017	15,232	827	12,542	11,388	188	259
Owner occupied - commercial real estate	1,790	973	817	1,790	400	1,811	1,844	-	-
Real estate mortgage – residential	333	333	-	333	-	336	340	-	-
Construction - commercial and residential	5,608	5,037	571	5,608	350	5,625	7,176	100	298
Home equity	661	116	545	661	338	774	959	-	-
Other consumer	72	72	-	72	-	45	40	1	2
Total	$ 33,833	$ 18,409	$ 11,287	$ 29,696	$ 4,227	$29,111	$31,794	$328	$607
December 31, 2014									
Commercial	$ 14,075	$ 1,603	$ 11,372	$ 12,975	$ 5,334	$14,203	$13,681	$20	$251

Income producing - commercial real estate	10,869	8,952	1,542	10,494	751	8,202	7,021	196	203
Owner occupied - commercial real estate	1,889	1,038	851	1,889	577	2,696	3,986	-	6
Real estate mortgage – residential	346	346	-	346	-	348	529	-	-
Construction - commercial and residential	8,785	8,176	609	8,785	927	10,113	10,967	436	1,147
Home equity	1,398	339	1,059	1,398	430	993	747	32	36
Other consumer	58	-	58	58	45	29	30	7	7
Total	$ 37,420	$ 20,454	$ 15,491	$ 35,945	$ 8,064	$36,584	$36,961	$691	$1,650
September 30, 2014									
Commercial	$ 16,531	$ 950	$ 14,481	$ 15,431	$ 4,409	$12,051	$12,132	$228	$231
Investment - commercial real estate	6,284	4,839	1,070	5,909	578	5,975	5,873	(71)	7
Owner occupied - commercial	3,502	391	3,111	3,502	1,330	3,366	4,877	6	6
Real estate mortgage – residential	350	350	-	350	-	500	665	-	-
Construction - commercial and residential	11,931	9,785	1,655	11,440	1,478	11,429	12,004	159	711
Home equity	588	125	463	588	218	496	553	4	4
Other consumer	-	-	-	-	-	-	33	-	-
Total	$ 39,186	$ 16,440	$ 20,780	$ 37,220	$ 8,013	$33,817	$36,137	$326	$959

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Modifications

A modification of a loan constitutes a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying a loan. Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Construction loans modified in a TDR may also involve extending the interest-only payment period.

Loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance associated with the loan. An allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

The following table presents by class, the recorded investment of loans modified in TDRs held by the Company during the periods ended September 30, 2015 and December 31, 2014.

(dollars in thousands)	**Number of Contracts**	**TDRs Performing to Modified Terms**	**TDRs Not Performing to Modified Terms**	**Total TDRs**
September 30, 2015				
Commercial	4	$ 1,172	$ 215	$1,387
Income producing - commercial real estate	4	8,512	-	8,512
Owner occupied - commercial real estate	1	509	-	509
Construction - commercial and residential	1	5,037	-	5,037
Total	10	$ 15,230	$ 215	$15,445
December 31, 2014				
Commercial	1	$ -	$ 227	$227
Income producing - commercial real estate	3	7,849	-	7,849
Owner occupied - commercial real estate	1	565	-	565
Construction - commercial and residential	1	5,088	-	5,088
Total	6	$ 13,502	$ 227	$13,729

During the nine months of 2015, there were no defaults on restructured loans, as compared to the nine months of 2014, which had one default on a $2.1 million restructured loan. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. There were no nonperforming TDRs reclassified to nonperforming loans during the nine months ended September 30, 2015. There was one nonperforming TDR totaling $2.1 million reclassified to nonperforming loans during the nine months ended September 30, 2014. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were three loans modified in a TDR during the three months ended September 30, 2015. During the nine months ended September 30, 2015, there were a total of four loans modified in a TDR. There was one loan modified in a TDR during the three and nine months ended September 30, 2014.

Note 6. Interest Rate Swap Derivatives

The Company uses interest rate swap agreements to assist in its interest rate risk management. The notional amounts of the interest rate swaps do not represent amounts exchanged by the counterparties, but rather, the notional amount is used to determine, along with other terms of the derivative, the amounts to be exchanged between the counterparties.

The Company's objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company has entered into interest rate swaps as part of its interest rate risk management strategy. These interest rate swaps are designated as cash flow hedges and involve the receipt of variable rate amounts from counterparty in exchange for the Company making fixed payments. As of September 30, 2015, the Company had three forward starting interest rate swap transactions outstanding that had a notional amount of $250 million associated with the Company's variable rate deposits.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings), net of tax, and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions. The Company did not recognize any hedge ineffectiveness in earnings during the period ended September 30, 2015.

The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of ten months (excluding forecasted transactions related to the payment of variable interest on existing financial instruments) and as such existing hedges are deemed forward starting swaps and no net settlements of cash flows is occurring.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest income/expense as interest payments are made/received on the Company's variable-rate assets/liabilities. During the quarter ended September 30, 2015, the Company did not have any reclassifications to interest expense. During the next twelve months, the Company estimates (based on existing interest rates) that $1.46 million will be reclassified as an increase in interest expense.

The Company is exposed to credit risk in the event of nonperformance by the interest rate swap counterparty. The Company minimizes this risk by entering into derivative contracts with only large, stable financial institutions, and the Company has not experienced, and does not expect, any losses from counterparty nonperformance on the interest rate swaps. The Company monitors counterparty risk in accordance with the provisions of ASC Topic 815, *"Derivatives and Hedging."* In addition, the interest rate swap agreements contain language outlining collateral-pledging requirements for each counterparty. Collateral must be posted when the market value exceeds certain threshold limits.

The table below identifies the balance sheet category and fair values of the Company's derivative instruments designed as cash flow hedges as of September 30, 2015. There were no derivative instruments as of December 31, 2014 or September 30, 2014.

September 30, 2015	**Swap Number**	**Notional Amount**	**Fair Value**	**Balance Sheet Category**	**Receive Rate**	**Pay Rate**	**Maturity**
(dollars in thousands)							
Interest rate swap	(1)	$75,000	$(996)	Other Liabilities	1 month USD-LIBOR-BBA w/ -1 day lookback +10 basis points	1.71 %	March 31, 2020
Interest rate swap	(2)	100,000	(1,435)	Other Liabilities	Federal Funds Effective Rate +10 basis points	1.74 %	April 15, 2021
Interest rate swap	(3)	75,000	(1,014)	Other Liabilities	1 month USD-LIBOR-BBA w/ -1 day lookback +10 basis points	1.92 %	March 31, 2022

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The table below presents the pre-tax net gains (losses) of the Company's cash flow hedges for the nine months ended September 30, 2015. Since all transactions are forward starting swaps all amounts are balance sheet related (AOCI), and no amounts were recorded in the income statement.

		Nine Months Ended September 30, 2015				
		Effective Portion			Ineffective Portion	
			Reclassified from AOCI into income		Recognized in Income on Derivatives	
(dollars in thousands)	Swap Number	Amount of Pre-tax gain (loss) Recognized in OCI	Category	Amount of Gain (Loss)	Category	Amount of Gain (Loss)
Interest rate swap	(1)	$(996)		$ -		$ -
Interest rate swap	(2)	(1,435)		-		-
Interest rate swap	(3)	(1,014)		-		-

Note 7. Other Real Estate Owned

The activity within Other Real Estate Owned ("OREO") for the three and nine months ended September 30, 2015 and 2014 is presented in the table below. There are no residential real estate loans in the process of foreclosure as of September 30, 2015. For the three and nine months ended September 30, 2015, proceeds on sales of OREO were $860 thousand and $1.8 million, respectively. The net losses on sales were $44 thousand and $209 thousand for the three and nine months ended September 30, 2015.

	Three Months Ended		Nine Months Ended	
(dollars in thousands)	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Balance beginning of period	$10,715	$ 8,809	$13,224	$ 9,225
Real estate acquired from borrowers	225	85	1,725	330
Valuation allowance	-	(51)	(750)	(505)
Properties sold	(988)	(220)	(4,247)	(427)

Balance end of period	$9,952	$ 8,623	$9,952	$ 8,623

Note 8. Net Income per Common Share

The calculation of net income per common share for the three and nine months ended September 30, 2015 and 2014 was as follows.

(dollars and shares in thousands, except per share data)	**Three Months Ended September 30, 2015**	**2014**	**Nine Months Ended September 30, 2015**	**2014**
Basic:				
Net income available to common shareholders	$21,283	$13,937	$61,280	$39,097
Average common shares outstanding	33,401	26,024	32,625	25,978
Basic net income per common share	$0.64	$0.54	$1.88	$1.50
Diluted:				
Net income available to common shareholders	$21,283	$13,937	$61,280	$39,097
Average common shares outstanding	33,401	26,024	32,625	25,978
Adjustment for common share equivalents	625	630	653	640
Average common shares outstanding-diluted	34,026	26,654	33,278	26,618
Diluted net income per common share	$0.63	$0.52	$1.84	$1.47
Anti-dilutive shares	-	21	11	21

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Note 9. Stock-Based Compensation

The Company maintains the 1998 Stock Option Plan (“1998 Plan”), the 2006 Stock Plan (“2006 Plan”) and the 2011 Employee Stock Purchase Plan (“2011 ESPP”).

In connection with the acquisition of Fidelity & Trust Financial Corporation (“Fidelity”), the Company assumed the Fidelity 2004 Long Term Incentive Plan and the 2005 Long Term Incentive Plan (the “Fidelity Plans”).

In connection with the acquisition of Virginia Heritage, the Company assumed the Virginia Heritage 2006 Stock Option Plan and the 2010 Long Term Incentive Plan (the “Virginia Heritage Plans”).

No additional options may be granted under the 1998 Plan, the Fidelity Plans or the Virginia Heritage Plans.

The 2006 Plan provides for the issuance of awards of incentive stock options, non-qualifying stock options, restricted stock and stock appreciation rights to selected key employees and members of the Board. As amended, 1,996,500 shares of common stock are subject to issuance pursuant to awards under the 2006 Plan. Stock options and restricted stock awards are made with an exercise price equal to the average of the high and low price of the Company’s shares at the date of grant.

For awards that are service based, compensation expense is being recognized over the service (vesting) period based on fair value, which for stock option grants is computed using the Black-Scholes model, and for restricted stock awards is based on the average of the high and low stock price of the Company’s shares on the date of grant. For awards that are performance-based, compensation expense is recorded based on the probability of achievement of the goals underlying the grant. No performance-based awards are outstanding at September 30, 2015.

In February 2015, the Company awarded 77,370 shares of restricted stock to senior officers, directors and employees. The shares vest in three substantially equal installments beginning on the first anniversary of the date of grant.

In March 2015, the Company awarded 700 shares of restricted stock to an employee. The shares vest in five substantially equal installments beginning on the first anniversary of the date of grant.

Below is a summary of changes in shares pursuant to our equity compensation plans for the nine months ended September 30, 2015 and 2014. The information excludes restricted stock units and awards.

	Nine Months Ended September 30,					
	2015			2014		
	Shares	Weighted-Average Exercise Price		Shares	Weighted-Average Exercise Price	
Beginning balance	759,683	$	11.36	503,834	$	10.41
Issued	-		-	21,000		32.77
Exercised	(377,357)		12.73	(64,926)		16.78
Forfeited	(12,380)		29.58	(110)		5.76
Expired	(8,476)		17.32	(1,225)		9.00
Ending balance	361,470	$	9.16	458,573	$	10.54

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The following summarizes information about stock options outstanding at September 30, 2015. The information excludes restricted stock units and awards.

Outstanding:		**Stock Options**	**Weighted-Average**	**Weighted-Average Remaining**
Range of Exercise Prices		**Outstanding**	**Exercise Price**	**Contractual Life**
$5.76	$9.21	221,669	$ 5.76	3.28
$9.22	$15.47	108,611	12.40	2.15
$15.48	$22.66	18,794	19.28	7.75
$22.67	$32.36	12,396	26.18	2.19
		361,470	$ 9.16	3.13

Exercisable:		**Stock Options**	**Weighted-Average**
Range of Exercise Prices		**Exercisable**	**Exercise Price**
$5.76	$9.21	164,759	$ 5.76
$9.22	$15.47	101,941	12.51
$15.48	$22.66	15,164	19.60
$22.67	$32.36	10,896	26.36
		292,760	$ 9.60

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions as shown in the table below used for grants during the years ended December 31, 2014 and 2013. There were no grants of stock options during the nine months ended September 30, 2015.

	Nine Months Ended September 30, 2015	**Years Ended December 31,**	
		2014	**2013**
Expected volatility	N/A	34.25%	34.12%
Weighted-Average volatility	N/A	34.25%	34.12%
Expected dividends	0.0 %	0.0 %	0.0 %
Expected term (in years)	N/A	9.4	7.5
Risk-free rate	N/A	2.26 %	1.31 %
Weighted-average fair value (grant date)	N/A	$13.49	$7.83

The expected lives are based on the "simplified" method allowed by ASC Topic 718 *"Compensation,"* whereby the expected term is equal to the midpoint between the vesting period and the contractual term of the award.

The total intrinsic value of outstanding stock options and outstanding exercisable stock options was $10.6 million at September 30, 2015. The total intrinsic value of stock options exercised during the nine months ended September 30, 2015 and 2014 was $8.5 million and $1.1 million, respectively. The total fair value of stock options vested was $87 thousand and $125 thousand for the nine months ended September 30, 2015 and 2014, respectively. Unrecognized stock-based compensation expense related to stock options totaled $69 thousand at September 30, 2015. At such date, the weighted-average period over which this unrecognized stock option expense is expected to be recognized was 2.68 years.

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The Company has unvested restricted stock award grants of 387,753 shares under the 2006 Plan at September 30, 2015. Unrecognized stock based compensation expense related to restricted stock awards totaled $6.6 million at September 30, 2015. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 1.66 years. The following table summarizes the unvested restricted stock awards at September 30, 2015 and 2014.

	Nine Months Ended September 30,			
	2015		**2014**	
	Shares	**Weighted-Average Grant Date Fair Value**	**Shares**	**Weighted-Average Grant Date Fair Value**
Unvested at beginning	509,336	$ 21.58	614,580	$ 18.71
Issued	78,070	36.06	78,947	33.24
Forfeited	(4,150)	31.83	(832)	23.59
Vested	(195,503)	20.74	(184,921)	17.54
Unvested at end	387,753	$ 24.81	507,774	$ 21.33

Approved by shareholders in May 2011, the 2011 ESPP reserved 550,000 shares of common stock (as adjusted for stock dividends) for issuance to employees. Whole shares are sold to participants in the plan at 85% of the lower of the stock price at the beginning or end of each quarterly offering period. The 2011 ESPP is available to all eligible employees who have completed at least one year of continuous employment, work at least 20 hours per week and at least five months a year. Participants may contribute a minimum of $10 per pay period to a maximum of $6,250 per offering period or $25,000 annually (not to exceed more than 10% of compensation per pay period). At September 30, 2015, the 2011 ESPP had 437,727 shares remaining for issuance.

Included in salaries and employee benefits the Company recognized $3.7 million and $2.9 million in stock-based compensation expense for the nine months ended September 30, 2015 and 2014, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

Note 10. Other Comprehensive Income

The following table presents the components of other comprehensive income (loss) for the three and nine months ended September 30, 2015 and 2014.

(dollars in thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended September 30, 2015			
Net unrealized gain on securities available-for-sale	$3,512	$1,405	$2,107
Net unrealized loss on derivatives	(6,627)	(2,651)	(3,976)
Less: Reclassification adjustment for net gains included in net income	(60)	(24)	(36)
Other Comprehensive Loss	$(3,175)	$(1,270)	$(1,905)
Three Months Ended September 30, 2014			
Net unrealized loss on securities available-for-sale	$(543)	$(217)	$(326)
Less: Reclassification adjustment for net gains included in net income	-	-	-
Other Comprehensive Loss	$(543)	$(217)	$(326)
Nine Months Ended September 30, 2015			
Net unrealized gain on securities available-for-sale	$3,325	$1,330	$1,995
Net unrealized loss on derivatives	(3,445)	(1,378)	(2,067)
Less: Reclassification adjustment for net gains included in net income	(2,224)	(890)	(1,334)
Other Comprehensive Loss	$(2,344)	$(938)	$(1,406)
Nine Months Ended September 30, 2014			
Net unrealized gain on securities available-for-sale	$8,062	$3,225	$4,837
Less: Reclassification adjustment for net gains included in net income	(10)	(4)	(6)
Other Comprehensive Income	$8,052	$3,221	$4,831

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The following table presents the changes in each component of accumulated other comprehensive income (loss), net of tax, for the three and nine months ended September 30, 2015 and 2014.

(dollars in thousands)	**Securities Available For Sale**	**Derivatives**	**Accumulated Other Comprehensive (Loss) Income**
Three Months Ended September 30, 2015			
Balance at Beginning of Period	$ 3,146	$ -	$ 3,146
Other comprehensive income (loss) before reclassifications	2,107	(3,976)	(1,869)
Amounts reclassified from accumulated other comprehensive income	(36)	-	(36)
Net other comprehensive income (loss) during period	2,071	(3,976)	(1,905)
Balance at End of Period	$ 5,217	$ (3,976)	$ 1,241
Three Months Ended September 30, 2014			
Balance at Beginning of Period	$ 1,838	$ -	$ 1,838
Other comprehensive loss before reclassifications	(326)	-	(326)
Amounts reclassified from accumulated other comprehensive income	-	-	-
Net other comprehensive (loss) during period	(326)	-	(326)
Balance at End of Period	$ 1,512	$ -	$ 1,512
Nine Months Ended September 30, 2015			
Balance at Beginning of Period	$ 2,647	$ -	$ 2,647
Other comprehensive income (loss) before reclassifications	1,995	(2,067)	(72)
Amounts reclassified from accumulated other comprehensive income	(1,334)	-	(1,334)
Net other comprehensive income (loss) during period	661	(2,067)	(1,406)
Balance at End of Period	$ 3,308	$ (2,067)	$ 1,241
Nine Months Ended September 30, 2014			
Balance at Beginning of Period	$ (3,319)	$ -	$ (3,319)
Other comprehensive income before reclassifications	4,837	-	4,837
Amounts reclassified from accumulated other comprehensive income	(6)	-	(6)
Net other comprehensive income during period	4,831	-	4,831
Balance at End of Period	$ 1,512	$ -	$ 1,512

The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three and nine months ended September 30, 2015 and 2014.

	Amount Reclassified from	**Affected Line Item in**

Details about Accumulated Other Comprehensive Income Components (dollars in thousands)	**Accumulated Other Comprehensive (Loss) Income Three Months Ended September 30,**		**the Statement Where Net Income is Presented**
	2015	**2014**	
Realized gain on sale of investment securities	$ 60	$ -	Gain on sale of investment securities
	(24)	-	Tax Expense
Total Reclassifications for the Period	$ 36	$ -	Net of Tax

Details about Accumulated Other Comprehensive Income Components (dollars in thousands)	**Amount Reclassified from Accumulated Other Comprehensive (Loss) Income Nine Months Ended September 30,**		**Affected Line Item in the Statement Where Net Income is Presented**
	2015	**2014**	
Realized gain on sale of investment securities	$ 2,224	$ 10	Gain on sale of investment securities
	(890)	(4)	Tax Expense
Total Reclassifications for the Period	$ 1,334	$ 6	Net of Tax

Note 11. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, *"Fair Value Measurements and Disclosures,"* establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1	Quoted prices in active exchange markets for identical assets or liabilities; also includes certain U.S. Treasury and other U.S. Government and agency securities actively traded in over-the-counter markets.
Level 2	Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data; also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency securities, corporate debt securities, derivative instruments, and residential mortgage loans held for sale.
Level 3	Unobservable inputs supported by little or no market activity for 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 value requires significant management judgment or estimation; also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data. This category generally includes certain private equity investments, retained interests from securitizations, and certain collateralized debt obligations.

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Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2015 and December 31, 2014.

(dollars in thousands)	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total (Fair Value)**
September 30, 2015				
Assets:				
Investment securities available for sale:				
U. S. Government agency securities	$ -	$ 69,078	$ -	$ 69,078
Residential mortgage backed securities	-	322,020	-	322,020
Municipal bonds	-	117,866	-	117,866
Corporate bonds	-	15,018	-	15,018
Other equity investments	125	-	219	344
Loans held for sale	-	35,713	-	35,713
Mortgage banking derivatives	-	-	197	197
Interest rate swap derivatives	-	-	-	-
Total assets measured at fair value on a recurring basis as of September 30, 2015	$ 125	$ 559,695	$ 416	$ 560,236
Liabilities:				
Interest rate swap derivatives	-	3,445	-	3,445
Total liabilities measured at fair value on a recurring basis as of September 30, 2015	$ -	$ 3,445	$ -	$ 3,445

(dollars in thousands)	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total (Fair Value)**
December 31, 2014				
Assets:				
Investment securities available for sale:				
U. S. Government agency securities	$ -	$ 29,894	$ -	$ 29,894

Residential mortgage backed securities	-	240,320	-	240,320
Municipal bonds	-	111,712	-	111,712
Other equity investments	198	-	219	417
Loans held for sale	-	44,317	-	44,317
Mortgage banking derivatives	-	-	146	146
Total assets measured at fair value on a recurring basis as of December 31, 2014	$ 198	$ 426,243	$ 365	$426,806
Liabilities:				
Interest rate swap derivatives	-	-	-	-
Total liabilities measured at fair value on a recurring basis as of September 30, 2014	$ -	$ -	$ -	$ -

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include U.S. Government agency debt securities, mortgage backed securities issued by government sponsored entities and municipal bonds. Securities classified as Level 3 include securities in less liquid markets, the carrying amount approximate the fair value.

Loans held for sale: Loans held for sale are carried at the fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the consolidated statements of operations. As such, the Company classifies loans subjected to fair value adjustments as Level 2 valuation.

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The following is a reconciliation of activity for assets and liabilities measured at fair value based on Significant Other Unobservable Inputs (Level 3):

(dollars in thousands)	**Other Equity Investments**	**Derivative Assets/(Liabilities)**	**Total**
Assets:			
Beginning balance at December 31, 2014	$ 219	$ 146	$ 365
Realized gain (loss) included in earnings - net mortgage banking derivatives	-	51	51
Principal redemption	-	-	-
Ending balance at September 30, 2015	$ 219	$ 197	$ 416
Liabilities:			
Beginning balance at December 31, 2014	$ -	$ 250	$ 250
Realized gain (loss) included in earnings - net mortgage banking derivatives	-	(5)	(5)
Principal redemption	-	-	-
Ending balance at September 30, 2015	$ -	$ 245	$ 245

(dollars in thousands)	**Other Equity Investments**	**Derivative Assets/(Liabilities)**	**Total**
Assets:			
Beginning balance at December 31, 2013	$ 219	$ -	$ 219
Realized gain (loss) included in earnings - net mortgage banking derivatives	-	146	146
Ending balance at December 31, 2014	$ 219	$ 146	$ 365
Liabilities:			
Beginning balance at December 31, 2013	$ -	$ -	$ -
Realized gain (loss) included in earnings - net mortgage banking derivatives	-	250	250
Ending balance at December 31, 2014	$ -	$ 250	$ 250

Securities classified as Level 3 include securities in less liquid markets, the carrying amount approximate the fair value. The securities consist of equity investments in the form of common stock of two local banking companies which are not publicly traded.

The Company relies on a third-party pricing service to value its mortgage banking derivative financial assets and liabilities, which the Company classifies as a Level 3 valuation. The external valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, includes grouping the interest rate lock commitments by interest rate and terms, applying an estimated pull-through rate based on historical experience, and then multiplying by quoted investor prices determined to be reasonably applicable to the loan commitment groups based on interest rate, terms, and rate lock expiration dates of the loan commitment groups. The Company also relies on an external valuation model to estimate the fair value of its forward commitments to sell residential mortgage loans (i.e., an estimate of what the Company would receive or pay to terminate the forward delivery contract based on market prices for similar financial instruments), which includes matching specific terms and maturities of the forward commitments against applicable investor pricing.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company measures certain assets at fair value on a nonrecurring basis and the following is a general description of the methods used to value such assets.

Impaired loans: The Company considers a loan impaired when it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the note agreement, including both principal and interest. Management has determined that nonaccrual loans and loans that have had their terms restructured in a troubled debt restructuring meet this impaired loan definition. For individually evaluated impaired loans, the amount of impairment is based upon the present value of expected future cash flows discounted at the loan’s effective interest rate or the estimated fair value of the underlying collateral for collateral-dependent loans, which the Company classifies as a Level 3 valuation.

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Other real estate owned: Other real estate owned is initially recorded at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral, which the Company classifies as a Level 3 valuation. Assets measured at fair value on a nonrecurring basis are included in the table below:

(dollars in thousands)	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total (Fair Value)**
September 30, 2015				
Impaired loans:				
Commercial	$ -	$ 279	$ 2,237	$2,516
Income producing - commercial real estate	-	5,587	307	5,894
Owner occupied - commercial real estate	-	282	599	881
Real estate mortgage - residential	-	-	333	333
Construction - commercial and residential	-	-	221	221
Home equity	-	198	125	323
Other consumer	-	-	72	72
Other real estate owned	-	9,494	458	9,952
Total assets measured at fair value on a nonrecurring basis as of September 30, 2015	$ -	$ 15,840	$ 4,352	$20,192

(dollars in thousands)	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total (Fair Value)**
December 31, 2014				
Impaired loans:				
Commercial	$ -	$ 781	$ 7,171	$7,952
Income producing - commercial real estate	-	703	1,199	1,902
Owner occupied - commercial real estate	-	-	824	824
Real estate mortgage - residential	-	-	346	346
Construction - commercial and residential	-	-	3,297	3,297
Home equity	-	5	963	968
Other consumer	-	-	13	13
Other real estate owned	-	9,184	4,040	13,224
Total assets measured at fair value on a nonrecurring basis as of December 31, 2014	$ -	$ 10,673	$ 17,853	$28,526

Loans

The Company does not record loans at fair value on a recurring basis; however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, *"Receivables."* The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At September 30, 2015, substantially all of the totally impaired loans were evaluated based upon the fair value of the collateral. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

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Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by quoted market price, if one exists.

Quoted market prices, if available, are shown as estimates of fair value. Because no quoted market prices exist for a portion of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the net realizable value could be materially different from the estimates presented below. In addition, the estimates are only indicative of individual financial instrument values and should not be considered an indication of the fair value of the Company taken as a whole.

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

Cash due from banks and federal funds sold: For cash and due from banks and federal funds sold the carrying amount approximates fair value.

Interest bearing deposits with other banks: Values are estimated by discounting the future cash flows using the current rates at which similar deposits would be earning.

Investment securities: For these instruments, fair values are based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Federal Reserve and Federal Home Loan Bank stock: The carrying amount approximate the fair values at the reporting date.

Loans held for sale: Fair values for residential mortgage loans held for sale are at the carrying value (lower of cost or market) since such loans are typically committed to be sold (servicing released) at a profit.

Loans: For variable rate loans that re-price on a scheduled basis, fair values are based on carrying values. The fair value of the remaining loans are estimated by discounting the estimated future cash flows using the current interest rate at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term.

Bank owned life insurance: The fair value of bank owned life insurance is the current cash surrender value, which is the carrying value.

Annuity investment: The fair value of the annuity investments is the carrying amount at the reporting date.

Mortgage banking derivatives: These derivative instruments, which are classified as Level 3 of the fair value hierarchy, are used to hedge residential mortgage loans held for sale that utilize mandatory delivery and the related interest rate lock commitments and include forward commitments to sell those loans. The fair values of derivative financial instruments are based on derivative market data inputs as of the valuation date and the underlying value of mortgage loans for interest rate lock commitments.

Interest rate swap derivatives: These derivative instruments consist of forward starting interest rate swap agreements, which are accounted for as cash flow hedges. The Company's derivative position is classified within Level 2 of the fair value hierarchy and is valued using models generally accepted in the financial services industry and that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations. The fair value of the derivatives are determined using discounted cash flow models. These models’ key assumptions include the contractual terms of the respective contract along with significant observable inputs, including interest rates, yield curves, nonperformance risk and volatility. Derivative contracts are executed with a Credit Support Annex, which is a bilateral ratings-sensitive agreement that requires collateral postings when the market value exceeds certain threshold limits. These agreements protect the interests of the Company and its counterparties should either party suffer a credit rating deterioration.

Noninterest bearing deposits: The fair value of these deposits is the amount payable on demand at the reporting date, since generally accepted accounting standards do not permit an assumption of core deposit value.

Interest bearing deposits: The fair value of interest bearing transaction, savings, and money market deposits with no defined maturity is the amount payable on demand at the reporting date, since generally accepted accounting standards do not permit an assumption of core deposit value.

Certificates of deposit: The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits with remaining maturities would be accepted.

Customer repurchase agreements: The carrying amount approximate the fair values at the reporting date.

Borrowings: The carrying amount for variable rate borrowings approximate the fair values at the reporting date. The fair value of fixed rate FHLB advances and the subordinated notes are estimated by computing the discounted value of contractual cash flows payable at current interest rates for obligations with similar remaining terms. The fair value of variable rate FHLB advances is estimated to be carrying value since these liabilities are based on a spread to a current pricing index.

Off-balance sheet items: Management has reviewed the unfunded portion of commitments to extend credit, as well as standby and other letters of credit, and has determined that the fair value of such instruments is equal to the fee, if any, collected and unamortized for the commitment made.

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The estimated fair values of the Company’s financial instruments at September 30, 2015 and December 31, 2014 are as follows:

			Fair Value Measurements		
(dollars in thousands)	**Carrying Value**	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
September 30, 2015					
Assets					
Cash and due from banks	$10,703	$10,703	$-	$10,703	$ -
Federal funds sold	4,076	4,076	-	4,076	-
Interest bearing deposits with other banks	291,276	291,276	-	291,276	-
Investment securities	524,326	524,326	125	523,982	219
Federal Reserve and Federal Home Loan Bank stock	16,865	16,865	-	16,865	-
Loans held for sale	35,713	35,713	-	35,713	-
Loans	4,776,965	4,778,753	-	6,346	4,772,407
Bank owned life insurance	58,284	58,284	-	58,284	-
Annuity investment	12,137	12,137	-	12,137	-
Mortgage banking derivatives	197	197	-	-	197
Interst rate swap derivatives	-	-	-	-	-
Liabilities					
Noninterest bearing deposits	1,402,447	1,402,447	-	1,402,447	-
Interest bearing deposits	2,722,026	2,722,026	-	2,722,026	-
Certificates of deposit	802,115	802,449	-	802,449	-
Customer repurchase agreements	64,893	64,893	-	64,893	-
Borrowings	70,000	70,000	-	70,000	-
Mortgage banking derivatives	245	245	-	-	245
Interst rate swap derivatives	3,445	3,445	-	3,445	-
December 31, 2014					
Assets					
Cash and due from banks	$9,097	$9,097	$-	$9,097	$ -
Federal funds sold	3,516	3,516	-	3,516	-
Interest bearing deposits with other banks	243,412	243,412	-	243,412	-
Investment securities	382,343	382,343	198	381,926	219

Federal Reserve and Federal Home Loan Bank stock	22,560	22,560	-	22,560	-
Loans held for sale	44,317	44,669	-	44,669	-
Loans	4,312,399	4,314,618	-	1,489	4,313,129
Bank owned life insurance	56,594	56,594	-	56,594	-
Annuity investment	11,277	11,277	-	11,277	-
Mortgage banking derivatives	146	146	-	-	146
Liabilities					
Noninterest bearing deposits	1,175,799	1,175,799	-	1,175,799	-
Interest bearing deposits	2,446,228	2,446,228	-	2,446,228	-
Certificates of deposit	688,741	688,067	-	688,067	-
Customer repurchase agreements	61,120	61,120	-	61,120	-
Borrowings	219,300	220,838	-	220,838	-
Mortgage banking derivatives	250	250	-	-	250

Note 12. Supplemental Executive Retirement Plan

The Bank has entered into Supplemental Executive Retirement and Death Benefit Agreements (the “SERP Agreements”) with certain of the Bank’s executive officers, which upon the executive’s retirement, will provide for a stated monthly payment for such executive’s lifetime, subject to certain death benefits described below. The retirement benefit is computed as a percentage of each executive’s projected average base salary over the five years preceding retirement, assuming retirement at age 67. The SERP Agreements provide that (a) the benefits vest ratably over six years of service to the Bank, with the executive receiving credit for years of service prior to entering into the SERP Agreement, (b) death, disability and change-in-control shall result in immediate vesting, and (c) the monthly amount will be reduced if retirement occurs earlier than age 67 for any reason other than death, disability or change-in-control. The SERP Agreements further provide for a death benefit in the event the retired executive dies prior to receiving 180 monthly installments, paid either in a lump sum payment or continued monthly installment payments, such that the executive’s beneficiary has received payment(s) sufficient to equate to a cumulative 180 monthly installments.

The SERP Agreements are unfunded arrangements maintained primarily to provide supplemental retirement benefits and comply with Section 409A of the Internal Revenue Code. The Bank financed the retirement benefits by purchasing fixed annuity contracts with four insurance carriers totaling $11.4 million that have been designed to provide a future source of funds for the lifetime retirement benefits of the SERP Agreements. The primary impetus for utilizing fixed annuities is a substantial savings in compensation expenses for the Bank as opposed to a traditional SERP Agreement. The cash surrender value of the annuity contracts was $12.1 million at September 30, 2015 and is included in other assets on the consolidated balance sheet. For the three and nine months ended September 30, 2015, the Company recorded benefit expense accruals of $255 thousand and $764 thousand for this post retirement benefit.

Upon death of an executive, the annuity contract related to such executive terminates. The Bank has purchased additional bank owned life insurance contracts, which would effectively finance payments (up to a 15 year certain amount) to the executives’ named beneficiaries.

Note 13. Subsequent Event

On November 2, 2015, Eagle Bancorp, Inc. (the “Company”), redeemed all of the 56,600 shares of the Company’s Senior Non-Cumulative Perpetual Preferred Stock, Series B, liquidation amount $1,000 per share (the “Series B Preferred Stock”) issued to the United States Secretary of the Treasury (the “Treasury”) in July 2011 pursuant to the Small Business Lending Fund program (“SBLF”), and all of the 15,300 shares of the Company’s Senior Non-Cumulative Perpetual Preferred Stock, Series C, liquidation amount $1,000 per share (“Series C Preferred Stock”), issued in October 2014 in connection with the Company’s acquisition of Virginia Heritage Bank (“VHB”) in exchange for VHB’s SBLF preferred stock originally issued to the Treasury in June 2011. The aggregate redemption price of the Series B Preferred Stock and Series C Preferred Stock was approximately $71.96 million, including dividends accrued but unpaid through, but not including the redemption date.

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

The following discussion provides information about the results of operations, and financial condition, liquidity, and capital resources of the Company and its subsidiaries as of the dates and periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and Notes thereto, appearing elsewhere in this report and the Management Discussion and Analysis in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

This report contains forward looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In some cases, forward- looking statements can be identified by use of such words as "may," "will," "anticipate," "believes," "expects," "plans," "estimates," "potential," "continue," "should," and similar words or phrases. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions, which by their nature are not susceptible to accurate forecast, and are subject to significant uncertainty. For details on factors that could affect these expectations, see the risk factors and other cautionary language included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 and in other periodic and current reports filed by the Company with the Securities and Exchange Commission. Because of these uncertainties and the assumptions on which this discussion and the forward-looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward looking statements.

GENERAL

The Company is a growth oriented, one-bank holding company headquartered in Bethesda, Maryland, which is currently celebrating seventeen years of successful operations. The Company provides general commercial and consumer banking services through the Bank, its wholly owned banking subsidiary, a Maryland chartered bank which is a member of the Federal Reserve System. The Company was organized in October 1997, to be the holding company for the Bank. The Bank was organized in 1998 as an independent, community oriented, full service banking alternative to the super regional financial institutions, which dominate the primary market area. The Company's philosophy is to provide superior, personalized service to its customers. The Company focuses on relationship banking, providing each customer with a number of services and becoming familiar with and addressing customer needs in a proactive, personalized fashion. As of September 30, 2015 the Bank has a total of twenty-two branch offices, including ten in Northern Virginia, seven in Montgomery County, Maryland, and five in Washington, D.C. During the fourth quarter, the Company intends to consolidate one Northern Virginia branch, resulting in a total of twenty-one branch offices.

The Bank offers a broad range of commercial banking services to its business and professional clients as well as full service consumer banking services to individuals living and/or working primarily in the Bank's market area. The Bank emphasizes providing commercial banking services to sole proprietors, small, and medium sized businesses, non-profit organizations and associations, and investors living and working in and near the primary service area. These services include the usual deposit functions of commercial banks, including business and personal checking accounts, "NOW" accounts and money market and savings accounts, business, construction, and commercial loans, residential mortgages and consumer loans, and cash management services. The Bank is also active in the origination and sale of residential mortgage loans and the origination of SBA loans. The residential mortgage loans are originated for sale to third-party investors, generally large mortgage and banking companies, under best efforts and mandatory delivery commitments with the investors to purchase the loans subject to compliance with pre-established criteria. The Bank generally sells the guaranteed portion of the SBA loans in a transaction apart from the loan origination generating noninterest income from the gains on sale, as well as servicing income on the portion participated. Bethesda Leasing, LLC, a subsidiary of the Bank, holds title to and manages Other Real Estate Owned ("OREO") assets. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Additionally, the Bank offers investment advisory services through referral programs with two third parties. ECV, a subsidiary of the Company, provides subordinated financing for the acquisition, development and/or construction of real estate projects. ECV lending involves higher levels of risk, together with commensurate expected returns.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or a valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility.

The fair values and the information used to record valuation adjustments for investment securities available-for-sale are based either on quoted market prices or are provided by other third-party sources, when available. The Company's investment portfolio is categorized as available-for-sale with unrealized gains and losses net of income tax being a component of shareholders' equity and accumulated other comprehensive (loss) income.

The allowance for credit losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two principles of accounting: (a) ASC Topic 450, *"Contingencies,"* which requires that losses be accrued when they are probable of occurring and are estimable and (b) ASC Topic 310, *"Receivables,"* which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, can be determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows, or values observable in the secondary markets.

Three components comprise our allowance for credit losses: a specific allowance, a formula allowance and a nonspecific or environmental factors allowance. Each component is determined based on estimates that can and do change when actual events occur.

The specific allowance allocates a reserve to identified impaired loans. Impaired loans are assigned specific reserves based on an impairment analysis. Under ASC Topic 310, *"Receivables,"* a loan for which reserves are individually allocated may show deficiencies in the borrower's overall financial condition, payment record, support available from financial guarantors and for the fair market value of collateral. When a loan is identified as impaired, a specific reserve is established based on the Company's assessment of the loss that may be associated with the individual loan.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as requiring specific reserves. The portfolio of unimpaired loans is stratified by loan type and risk assessment. Allowance factors relate to the type of loan and level of the internal risk rating, with loans exhibiting higher risk and loss experience receiving a higher allowance factor.

The environmental allowance is also used to estimate the loss associated with pools of non-classified loans. These non-classified loans are also stratified by loan type, and environmental allowance factors are assigned by management based upon a number of conditions, including delinquencies, loss history, changes in lending policy and procedures, changes in business and economic conditions, changes in the nature and volume of the portfolio, management expertise, concentrations within the portfolio, quality of internal and external loan review systems, competition, and legal and regulatory requirements.

The allowance captures losses inherent in the loan portfolio, which have not yet been recognized. Allowance factors and the overall size of the allowance may change from period to period based upon management’s assessment of the above described factors, the relative weights given to each factor, and portfolio composition.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including in connection with the valuation of collateral, a borrower’s prospects of repayment, and in establishing allowance factors on the formula and environmental components of the allowance. The establishment of allowance factors involves a continuing evaluation, based on management’s ongoing assessment of the global factors discussed above and their impact on the portfolio. The allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors can have a direct impact on the amount of the provision, and a related after tax effect on net income. Errors in management’s perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. Alternatively, errors in management’s perception and assessment of the global factors and their impact on the portfolio could result in the allowance being in excess of amounts necessary to cover losses in the portfolio, and may result in lower provisions in the future. For additional information regarding the provision for credit losses, refer to the discussion under the caption “Provision for Credit Losses” below.

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. Intangible assets that have finite lives, such as core deposit intangibles, are amortized over their estimated useful lives and subject to periodic impairment testing. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives.

Goodwill and other intangibles are subject to impairment testing at the reporting unit level, which must be conducted at least annually. The Company performs impairment testing during the fourth quarter of each year or when events or changes in circumstances indicate the assets might be impaired.

The Company performs a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing updated qualitative factors, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it does not have to perform the two-step goodwill impairment test. Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit under the second step of the goodwill impairment test are judgmental and often involve the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. Estimates of fair value are primarily determined using discounted cash flows, market comparisons and recent transactions. These approaches use significant estimates and assumptions including projected future cash flows, discount rates reflecting the market rate of return, projected growth rates and determination and evaluation of appropriate market comparables. Based on the results of quantitative assessments of all reporting units, the Company concluded that no impairment existed at December 31, 2014. However, future events could cause the Company to conclude that goodwill or other intangibles have become impaired, which would result in recording an impairment loss. Any resulting impairment loss could have a material adverse impact on the Company's financial condition and results of operations.

The Company follows the provisions of ASC Topic 718, *"Compensation,"* which requires the expense recognition for the fair value of share based compensation awards, such as stock options, restricted stock awards, and performance based shares. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. The accounting standard also allows for the use of alternative option pricing models which may impact fair value as determined. The Company's practice is to utilize reasonable and supportable assumptions.

RESULTS OF OPERATIONS

Earnings Summary

For the nine months ended September 30, 2015, the Company's net income was $61.8 million, a 56% increase (52% on an operating basis) over the $39.5 million ($40.8 million on an operating basis) for the nine months ended September 30, 2014. Net income available to common shareholders was $61.3 million ($1.88 per basic common share and $1.84 per diluted common share), as compared to $39.1 million ($40.3 million on an operating basis), or $1.50 per basic common share and $1.47 per diluted common share ($1.55 per basic common share and $1.52 per diluted common share on an operating basis) for the same nine month period in 2014, a 25% increase per basic and diluted share (21% increase per basic and diluted common share on an operating basis).

For the three months ended September 30, 2015, the Company’s net income was $21.5 million, a 52% increase over the $14.1 million net income ($14.8 million on an operating basis) for the three months ended September 30, 2014. Net income available to common shareholders for the three months ended September 30, 2015 increased 53% to $21.3 million as compared to $13.9 million ($14.6 million on an operating basis) for the same period in 2014. Net income per basic and diluted common share for the three months ended September 30, 2015 was $0.64 and $0.63, respectively as compared to $0.54 per basic common share and $0.52 per diluted common share ($0.57 per basic common share and $0.55 per diluted common share on an operating basis) for the same period in 2014, a 19% increase per basic common share and 21% per diluted common share (13% increase per basic common share and 15% per diluted common share on an operating basis).

Operating earnings for the three and nine months ended September 30, 2014, exclude merger related expenses net of tax of $674 thousand ($0.03 per basic and diluted shares) and $1.3 million ($0.05 per basic and diluted shares) related to the Merger with Virginia Heritage, respectively. Where it is appropriate, parenthetical references refer to operating earnings. Reconciliations of GAAP earnings to operating earnings are contained under the section “Use of Non-GAAP Financial Measures”.

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As of October 31, 2014, the Company completed the Merger, which added approximately $800 million in loans, $645 million in deposits and 35 full time salaried employees.

The increase in net income for the nine months ended September 30, 2015 can be attributed primarily to an increase in total revenue (i.e. net interest income plus noninterest income) of 37.1% over the same period in 2014. Net interest income grew 35.3% in the first nine months of 2015 as compared to the same period in 2014 due to average earning asset growth of 39.8%.

For the nine months ended September 30, 2015, the Company reported an annualized return on average assets (“ROAA”) of 1.49% as compared to 1.36% (1.40% on an operating basis) for the nine months ended September 30, 2014. The annualized return on common equity (“ROACE”) for the nine months ended September 30, 2015 was 12.41%, as compared to 14.33% (14.79% on an operating basis) for the nine months ended September 30, 2014, the lower ROACE due to the higher average capital position.

The increase in net income for the three months ended September 30, 2015 can be attributed primarily to an increase in total revenue (i.e. net interest income plus noninterest income) of 32.0% over the same period in 2014. Net interest income grew 32.4% for the three months ended September 30, 2015 as compared to the same period in 2014 due to average earning asset growth of 39.4%.

For the three months ended September 30, 2015, the Company reported an annualized ROAA of 1.47% as compared to 1.37% (1.44% on an operating basis) for the three months ended September 30, 2014. The annualized ROACE for the three months ended September 30, 2015 was 11.95%, as compared to 14.52% (15.22% on an operating basis) for the three months ended September 30, 2014, the lower ROACE due to the higher average capital position.

The net interest margin, which measures the difference between interest income and interest expense (i.e. net interest income) as a percentage of earning assets, decreased 14 basis points from 4.46% for the nine months ended September 30, 2014 to 4.32% for the nine months ended September 30, 2015. For the first nine months in 2015, the Company has been able to maintain its loan portfolio yields relatively close to 2014 levels (5.25% versus 5.40%) due to disciplined loan pricing practices, while maintaining a favorable deposit mix, largely resulting from ongoing efforts to increase and expand client relationships. Average earning assets yields were lower by 9 basis points (4.68% versus 4.77%) in the first nine months of 2015 as compared to the same period in 2014. The average cost of interest bearing liabilities increased by 8 basis points (from 0.47% to 0.55%) for the nine months ended September 30, 2015 as compared to same period in 2014. Combining the change in the yield on earning assets and the costs of interest bearing liabilities, the net interest spread decreased by 17 basis points for the first nine months in 2015 (4.13% versus 4.30%) as compared to 2014.

In spite of the decline in the net interest spread, the Company believes it has managed its cost of funds aggressively and been extremely disciplined in setting new loan rates. The benefit of noninterest sources funding earning assets increased by 3 basis points from 16 basis points to 19 basis points for the nine months ended September 30, 2015 versus the same period in 2014. The combination of a 17 basis point decrease in the net interest spread and a 3 basis point increase in the value of noninterest sources resulted in the 14 basis point decrease in the net interest margin for the first nine months of 2015 as compared to the same period in 2014. The net interest margin was positively impacted by 7 basis points in the nine months ended September 30, 2015 as a result of $2.8 million in amortization of the credit mark adjustment from the Merger.

The net interest margin as a percentage of earning assets decreased 22 basis points from 4.45% for the three months ended September 30, 2014 to 4.23% for the three months ended September 30, 2015. For the three months ended September 30, 2015, the Company has been able to maintain its loan portfolio yields relatively close to 2014 levels (5.19% versus 5.39%) due to disciplined loan pricing practices, while maintaining a favorable deposit mix, largely resulting from ongoing efforts to increase and expand client relationships. Average earning assets yields were lower by 20 basis points (4.58% versus 4.78%) for the quarter ended September 30, 2015 as compared to the same period in 2014. This decrease in average earning asset yields compares to an increase of 4 basis points (from 0.50% to 0.54%) in the cost of interest bearing liabilities. The net interest margin was positively impacted by 4 basis points in the three months ended September 30, 2015 as a result of $589 thousand in amortization of the credit mark adjustment from the Merger.

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The net interest spread decreased by 24 basis points for the three months ended September 30, 2015 (4.04% versus 4.28%) as compared to 2014, as the Company has managed its cost of funds aggressively and been extremely disciplined in setting new loan rates. The benefit of noninterest sources funding earning assets increased by 2 basis points from 17 basis points to 19 basis points for the three months ended September 30, 2015 versus the same period in 2014. The combination of a 24 basis point decrease in the net interest spread and a 2 basis point increase in the value of noninterest sources resulted in the 22 basis point decrease in the net interest margin for the three months ended September 30, 2015 as compared to the same period in 2014.

The Company believes it has effectively managed its net interest margin and net interest income over the past twelve months as average market interest rates have remained relatively low. This factor has been significant to overall earnings performance over the past twelve months as net interest income represents 90% of the Company’s total revenue for the nine months ended September 30, 2015.

On July 24, 2015, the Company completed the sale of the indirect consumer loan portfolio acquired in the Merger, amounting to approximately $80.3 million as of the time of sale. The sale of this non-strategic loan class allows the Company to deploy the funds into commercial and commercial real estate loans, its core competency, improve its yield on earning assets and reduce operating expenses. The fair value adjustment was included in the June 30, 2015 balance sheet as an adjustment to intangibles established in the Merger transaction.

For the first nine months of 2015, total loans grew 10.8% over December 31, 2014, and were 39.2% higher at September 30, 2015 as compared to September 30, 2014. For the nine months of 2015, total deposits increased 14.3% over December 31, 2014, and were 39.4% higher at September 30, 2015 than at September 30, 2014. Growth in loans and deposits over the last twelve months was in part due to the Merger with Virginia Heritage. Excluding balances acquired in the Merger, and the sale of the indirect consumer loan portfolio, organic loan and deposit growth over the last twelve months was 18% for loans and 21% for deposits.

In order to fund growth in average loans of 43.1% over the nine months ended September 30, 2015 as compared to the same period in 2014, as well as sustain significant liquidity, the Company has relied on both core deposit growth and brokered or wholesale deposits. The major component of the growth in core deposits has been growth in money market accounts primarily as a result of effectively building new and enhanced client relationships. Growth in average time deposits has derived primarily from significant time deposits acquired in the Merger, a CD special offer in the second quarter of 2015 which raised $50 million and increases in brokered deposit sources, which are both readily available and cost effective. Average total deposits grew by 38.1% for the first nine months of 2015 as compared to the same period in 2014.

In terms of the average asset composition or mix, loans, which generally have higher yields than securities and other earning assets, increased from 82.9% of average earning assets in the first nine months of 2014 to 84.9% of average earning assets in the first nine months of 2015. For the first nine months of 2015, as compared to the same period in 2014, average loans, excluding loans held for sale, increased $1.4 billion, a 43.1% increase. The increase in average loans in the first nine months of 2015 as compared to the first nine months of 2014 is primarily attributable to growth in both construction – commercial and residential, and investment commercial real estate loans. The mix of average investment securities for the nine month periods ended September 30, 2015 and 2014 amounted to 7.8% and 10.5% of average earning assets, respectively. The combination of federal funds sold, interest bearing deposits with other banks and loans held for sale averaged 7.3% of average earning assets in the first nine months of 2015 and 6.6% for the same period in 2014, due to the $1.5 billion increase in average earning assets for the nine months ended September 30, 2015 as compared to the same period in 2014. The average combination of federal funds sold, interest bearing deposits with other banks and loans held for sale increased $139.6 million for the nine months ended September 30, 2015 as compared to the same period in 2014.

As noted above, increases in average deposits in the first nine months of 2015, as compared to the first nine months of 2014, is attributable to growth in money market accounts and time deposits. Total borrowed funds (excluding customer repurchase agreements) were $70.0 million at September 30, 2015 as compared to $109.3 million at September 30, 2014, a 36.0% decrease, and $219.3 million at December 31, 2014, a 68.1% decrease. The decline in borrowed funds in the first nine months of 2015 as compared to December 31, 2014 was the result of the payoff of all FHLB advances and the $9.3 million in subordinated notes due 2021.

The provision for credit losses was $10.0 million for the nine months ended September 30, 2015 as compared to $7.2 million for the nine months ended September 30, 2014. The higher provisioning in the first nine months of 2015, as compared to the first nine months of 2014, is due to higher net charge-offs. Net charge-offs of $5.8 million in the first nine months of 2015 represented an annualized 0.17% of average loans, excluding loans held for sale, as compared to $3.1 million or an annualized 0.13% of average loans, excluding loans held for sale, in the first nine months of 2014. Net charge-offs in the first nine months of 2015 were attributable primarily to commercial and industrial loans ($4.6 million), home equity and other consumer ($736 thousand), and income producing-commercial real estate loans ($625 thousand), offset by a recovery in construction commercial real estate loans ($114 thousand).

The provision for credit losses was $3.3 million for the three months ended September 30, 2015 as compared to $2.1 million for the three months ended September 30, 2014. The higher provisioning in the third quarter of 2015, as compared to the third quarter of 2014, is due to higher net charge-offs and growth in the loan portfolio. Net charge-offs of $1.9 million in the third quarter of 2015 represented an annualized 0.16% of average loans, excluding loans held for sale, as compared to $709 thousand or an annualized 0.09% of average loans, excluding loans held for sale, in the third quarter of 2014. Net charge-offs in the third quarter of 2015 were attributable primarily to commercial and industrial loans.

At September 30, 2015 the allowance for credit losses represented 1.05% of loans outstanding, as compared to 1.07% at December 31, 2014, and 1.31% at September 30, 2014. The decrease in the allowance for credit losses as a percentage of total loans at September 30, 2015, as compared to September 30, 2014, from 1.31% to 1.05%, is due substantially to loans acquired in the Merger being accounted for at fair value in accordance with U.S. GAAP. The allowance for credit losses represented 348% of nonperforming loans, referred to as the Coverage Ratio, at September 30, 2015, as compared to 153% at September 30, 2014 and 205% at December 31, 2014, resulting primarily from a decrease in non-performing loans.

Total noninterest income for the nine months ended September 30, 2015 increased to $20.1 million from $13.0 million for the nine months ended September 30, 2014, a 54.5% increase. This increase was primarily due to $5.1 million higher gains on the sale of residential mortgage loans and to gains realized on the sale of investment securities of $2.2 million, offset by a $1.1 million loss on the early extinguishment of debt due to the early payoff of FHLB advances. Residential mortgage loans closed were $723 million for the first nine months of 2015 versus $389 million for the first nine months of 2014. Investment gains were realized in February 2015 to take advantage of market conditions. This decision to pay off the FHLB advances early was based upon the deposit growth in the quarter and expected benefits to the cost of funds going forward. Excluding investment securities gains and the loss on early extinguishment of debt, total noninterest income was $19.0 million for the nine months ended September 30, 2015, as compared to $13.0 million for the same period in 2014, a 46.2% increase.

Total noninterest income for the three months ended September 30, 2015 increased to $6.1 million from $4.8 million for the three months ended September 30, 2014, a 28.1% increase. This increase was primarily due to an increase of $1.1 million in gains on the sale of residential mortgage loans, offset by a decrease in SBA gains. Residential mortgage loans closed were $174.6 million for the third quarter in 2015 versus $162.8 million for the third quarter of 2014.

The efficiency ratio, which measures the ratio of noninterest expense to total revenue, was 42.86% for the nine months ended September 30, 2015, as compared to 50.38% (49.33% on an operating basis) for the same period in 2014. Total noninterest expenses totaled $82.1 million for the nine months ended September 30, 2015, as compared to $70.4 million ($68.9 million on an operating basis) for the nine months ended September 30, 2014, a 16.6% increase (19.1% on an operating basis). Cost increases for salaries and benefits were $4.2 million, due primarily to increased staff from the Merger, merit increases, employee benefit expense increases and incentive compensation. Premises and equipment expenses were $2.5 million higher, due to costs of additional branches and office space acquired in the Merger and to increases in leasing costs. Marketing and advertising expense increased by $761 thousand primarily due to costs associated with digital and print advertising and sponsorships. Data processing expense increased $1.0 million primarily due to increased accounts and transaction volume primarily arising out of the Merger and to higher network expenses. Higher FDIC expenses of $668 thousand were due to both higher average assets and higher deposit levels. Other expenses increased $3.5 million primarily due to costs and valuations associated with other real estate owned, franchise tax and higher core deposit intangible amortization.

Total noninterest expenses totaled $27.4 million for the three months ended September 30, 2015, as compared to $25.1 million ($24.3 million on an operating basis) for the three months ended September 30, 2014, a 9% increase (13% increase on an operating basis). Cost increases for salaries and benefits were $441 thousand, due primarily to increased staff from the Merger, merit increases, and employee benefit expense increases. Premises and equipment expenses were $600 thousand higher, due to costs of additional branches and office space acquired in the Merger and to increases in leasing costs. Marketing and advertising expense increased by $218 thousand primarily due to costs associated with digital and print advertising. Data processing expense increased $404 thousand primarily due to increased accounts and transaction volume primarily arising out of the Merger. Legal, accounting and professional fees increased by $323 thousand primarily due to professional fees. Higher FDIC expenses of $221 thousand were due to both average asset growth and higher deposit levels. Other expenses increased $938 thousand primarily due to franchise tax and core deposit intangible amortization. The efficiency ratio improved to 42.04% for the third quarter of 2015, as compared to 50.90% (49.11% on an operating basis) for the third quarter of 2014.

The ratio of common equity to total assets increased from 9.26% at September 30, 2014 to 12.13% at September 30, 2015, due primarily to the public offering of common stock completed during the first quarter of 2015 and to the issuance of common stock to consummate the Merger. As discussed later in “Capital Resources and Adequacy,” the regulatory capital ratios of the Bank and Company remain above well capitalized levels.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investment securities. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings. Noninterest bearing deposits and capital are other components representing funding sources (refer to discussion above under Results of Operations). Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

For the first nine months of 2015, net interest income increased 35.3% over the same period for 2014. Average loans increased $1.4 billion and average deposits increased by $1.3 billion. The net interest margin was 4.32% for the nine months of 2015, as compared to 4.46% for the nine months of 2014. The Company believes its net interest margin remains favorable as compared to its peer banking companies.

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The tables below presents the average balances and rates of the major categories of the Company’s assets and liabilities for the three and nine months ended September 30, 2015 and 2014. Included in the tables are a measurement of interest rate spread and margin. Interest rate spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest rate paid on interest bearing liabilities. While the interest rate spread provides a quick comparison of earnings rates versus cost of funds, management believes that margin provides a better measurement of performance. The net interest margin (as compared to net interest spread) includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

Eagle Bancorp, Inc.

Consolidated Average Balances, Interest Yields And Rates (Unaudited)

(dollars in thousands)

	Three Months Ended September 30,							
	2015				**2014**			
	Average Balance	**Interest**	**Average Yield/Rate**		**Average Balance**	**Interest**	**Average Yield/Rate**	
ASSETS								
Interest earning assets:								
Interest bearing deposits with other banks and other short-term investments	$374,778	$228	0.24	%	$209,997	$125	0.24	%
Loans held for sale (1)	38,373	374	3.90	%	45,069	457	4.06	%
Loans (1) (2)	4,636,298	60,632	5.19	%	3,317,731	45,045	5.39	%
Investment securities available for sale (2)	491,800	2,745	2.21	%	395,528	2,255	2.26	%
Federal funds sold	3,586	2	0.22	%	9,534	4	0.17	%
Total interest earning assets	5,544,835	63,981	4.58	%	3,977,859	47,886	4.78	%
Total noninterest earning assets	281,109				137,024			
Less: allowance for credit losses	49,540				43,969			
Total noninterest earning assets	231,569				93,055			
TOTAL ASSETS	$5,776,404				$4,070,914			
LIABILITIES AND SHAREHOLDERS' EQUITY								
Interest bearing liabilities:								
Interest bearing transaction	$202,885	$97	0.19	%	$116,315	$35	0.12	%
Savings and money market	2,453,141	2,092	0.34	%	1,945,816	1,575	0.32	%
Time deposits	797,472	1,550	0.77	%	372,695	579	0.62	%
Total interest bearing deposits	3,453,498	3,739	0.43	%	2,434,826	2,189	0.36	%
Customer repurchase agreements	56,624	33	0.23	%	69,579	38	0.21	%
Other short-term borrowings	3	-	-		-	-	-	

Long-term borrowings	72,509	1,124	6.07	%	82,670	1,024	4.85	%
Total interest bearing liabilities	3,582,634	4,896	0.54	%	2,587,075	3,251	0.50	%
Noninterest bearing liabilities:								
Noninterest bearing demand	1,389,208				1,035,405			
Other liabilities	26,283				11,064			
Total noninterest bearing liabilities	1,415,491				1,046,469			
Shareholders’ equity	778,279				437,370			
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$5,776,404				$4,070,914			
Net interest income		$59,085				$44,635		
Net interest spread			4.04	%			4.28	%
Net interest margin			4.23	%			4.45	%
Cost of funds			0.35	%			0.33	%

(1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled $3.2 million and $3.1 million for the three months ended September 30, 2015 and 2014, respectively.

(2) Interest and fees on loans and investments exclude tax equivalent adjustments.

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Eagle Bancorp, Inc.

Consolidated Average Balances, Interest Yields and Rates (Unaudited)

(dollars in thousands)

	Nine Months Ended September 30,							
	2015				**2014**			
	Average Balance	**Interest**	**Average Yield/Rate**		**Average Balance**	**Interest**	**Average Yield/Rate**	
ASSETS								
Interest earning assets:								
Interest bearing deposits with other banks and other short-term investments	$336,545	$604	0.24	%	$209,332	$379	0.24	%
Loans held for sale **(1)**	45,863	1,288	3.74	%	31,571	957	4.04	%
Loans **(1) (2)**	4,505,092	176,775	5.25	%	3,148,943	127,224	5.40	%
Investment securities available for sale **(2)**	412,912	7,189	2.33	%	398,298	6,911	2.32	%
Federal funds sold	6,992	13	0.25	%	8,867	11	0.17	%
Total interest earning assets	5,307,404	185,869	4.68	%	3,797,011	135,482	4.77	%
Total noninterest earning assets	279,388				135,526			
Less: allowance for credit losses	48,240				42,628			
Total noninterest earning assets	231,148				92,898			
TOTAL ASSETS	$5,538,552				$3,889,909			
LIABILITIES AND SHAREHOLDERS' EQUITY								
Interest bearing liabilities:								
Interest bearing transaction	$178,256	$208	0.16	%	$115,561	$135	0.16	%
Savings and money market	2,379,643	6,066	0.34	%	1,895,602	4,583	0.32	%
Time deposits	778,375	4,394	0.75	%	399,994	2,207	0.74	%
Total interest bearing deposits	3,336,274	10,668	0.43	%	2,411,157	6,925	0.38	%
Customer repurchase agreements	54,945	94	0.23	%	63,768	107	0.22	%
Other short-term borrowings	27,492	54	-		-	-	-	
Long-term borrowings	86,640	3,687	5.61	%	53,915	1,788	4.37	%
Total interest bearing liabilities	3,505,351	14,503	0.55	%	2,528,840	8,820	0.47	%
Noninterest bearing liabilities:								
Noninterest bearing demand	1,275,050				929,115			
Other liabilities	25,995				10,663			
Total noninterest bearing liabilities	1,301,045				939,778			
Shareholders’ equity	732,156				421,291			
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$5,538,552				$3,889,909			

Net interest income	$171,366		$126,662	
Net interest spread	4.13	%	4.30	%
Net interest margin	4.32	%	4.46	%
Cost of funds	0.36	%	0.31	%

(1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled $8.9 million and $8.4 million for the nine months ended September 30, 2015 and 2014, respectively.

(2) Interest and fees on loans and investments exclude tax equivalent adjustments.

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Provision for Credit Losses

The provision for credit losses represents the amount of expense charged to current earnings to fund the allowance for credit losses. The amount of the allowance for credit losses is based on many factors, which reflect management's assessment of the risk in the loan portfolio. Those factors include historical losses, economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company and Bank.

Management has developed a comprehensive analytical process to monitor the adequacy of the allowance for credit losses. This process and guidelines were developed utilizing, among other factors, the guidance from federal banking regulatory agencies. The results of this process, in combination with conclusions of the Bank's outside loan review consultant, support management's assessment as to the adequacy of the allowance at the balance sheet date. Please refer to the discussion under the caption "Critical Accounting Policies" for an overview of the methodology management employs on a quarterly basis to assess the adequacy of the allowance and the provisions charged to expense.

During the first nine months of 2015, the allowance for credit losses increased $4.2 million, reflecting $10.0 million in provision for credit losses and $5.8 million in net charge-offs during the period. The provision for credit losses was $10.0 million for the nine months ended September 30, 2015 as compared to $7.2 million for the nine months ended September 30, 2014. At September 30, 2015, the allowance for credit losses represented 1.05% of loans outstanding, compared to 1.07% at December 31, 2014 and 1.31% at September 30, 2014. The higher provisioning in the first nine months of 2015, as compared to the first nine months of 2014, is due to higher net charge-offs. Net charge-offs of $5.8 million represented an annualized 0.17% of average loans, excluding loans held for sale, in the first nine months of 2015, as compared to $3.1 million or an annualized 0.13% of average loans, excluding loans held for sale, for the same period of 2014.

As part of its comprehensive loan review process, the Bank's Board of Directors and Loan Committee or Credit Review Committee carefully evaluate loans which are past-due 30 days or more. The Committees make a thorough assessment of the conditions and circumstances surrounding each delinquent loan. The Bank's loan policy requires that loans be placed on nonaccrual if they are ninety days past-due, unless they are well secured and in the process of collection. Additionally, Credit Administration specifically analyzes the status of development and construction projects, sales activities and utilization of interest reserves in order to carefully and prudently assess potential increased levels of risk requiring additional reserves.

The maintenance of a high quality loan portfolio, with an adequate allowance for possible credit losses, will continue to be a primary management objective for the Company.

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The following table sets forth activity in the allowance for credit losses for the periods indicated.

	Nine Months Ended September 30,	
(dollars in thousands)	**2015**	**2014**
Balance at beginning of year	$46,075	$40,921
Charge-offs:		
Commercial	4,693	1,968
Income producing - commercial real estate	651	22
Owner occupied - commercial real estate	-	35
Real estate mortgage - residential	-	138
Construction - commercial and residential	-	1,426
Construction - C&I (owner occupied)	-	-
Home equity	644	379
Other consumer	182	84
Total charge-offs	6,170	4,052
Recoveries:		
Commercial	135	802
Income producing - commercial real estate	26	4
Owner occupied - commercial real estate	2	7
Real estate mortgage - residential	5	-
Construction - commercial and residential	114	77
Construction - C&I (owner occupied)	-	-
Home equity	5	8
Other consumer	85	8
Total recoveries	372	906
Net charge-offs	5,798	3,146
Additions charged to operations	10,043	7,179
Balance at end of period	$50,320	$44,954
Annualized ratio of net charge-offs during the period to average loans outstanding during the period	0.17 %	0.13 %

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The following table reflects the allocation of the allowance for credit losses at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses or charge-offs and does not restrict the use of the allowance to absorb losses in any category.

	September 30, 2015		**December 31, 2014**		**September 30, 2014**	
(dollars in thousands)	**Amount**	**% (1)**	**Amount**	**% (1)**	**Amount**	**% (1)**
Commercial	$11,640	21 %	$13,222	21 %	$13,173	23 %
Income producing - commercial real estate	13,715	42 %	11,442	40 %	11,201	41 %
Owner occupied - commercial real estate	3,100	10 %	2,954	11 %	3,315	10 %
Real estate mortgage - residential	1,066	3 %	1,259	3 %	980	4 %
Construction - commercial and residential	17,765	20 %	14,982	18 %	13,731	18 %
Construction - C&I (owner occupied)	1,159	1 %	643	1 %	905	1 %
Home equity	1,606	3 %	1,469	3 %	1,362	3 %
Other consumer	269	-	104	3 %	287	-
Total allowance	$50,320	100%	$46,075	100%	$44,954	100%

(1) Represents the percent of loans in each category to total loans.

Nonperforming Assets

As shown in the table below, the Company’s level of nonperforming assets, which are comprised of loans delinquent 90 days or more, nonaccrual loans, which includes the nonperforming portion of troubled debt restructurings (“TDRs”) and other real estate owned, totaled $24.4 million at September 30, 2015 representing 0.41% of total assets, as compared to $35.7 million of nonperforming assets, or 0.68% of total assets, at December 31, 2014 and $38.0 million of nonperforming assets, or 0.91% of total assets, at September 30, 2014. The Company had no accruing loans 90 days or more past due at September 30, 2015, December 31, 2014 or September 30, 2014. Management remains attentive to early signs of deterioration in borrowers’ financial conditions and to taking the appropriate action to mitigate risk. Furthermore, the Company is diligent in placing loans on nonaccrual status and believes, based on its loan portfolio risk analysis, that its allowance for credit losses, at 1.05% of total loans at September 30, 2015, is adequate to absorb potential credit losses within the loan portfolio at that date.

Included in nonperforming assets are loans that the Company considers to be impaired. Impaired loans are defined as those as to which we believe it is probable that we will not collect all amounts due according to the contractual terms of the loan agreement, as well as those loans whose terms have been modified in a TDR that have not shown a period of performance as required under applicable accounting standards. Valuation allowances for those loans determined to be impaired are evaluated in accordance with ASC Topic 310—“*Receivables,*” and updated quarterly. For collateral dependent impaired loans, the carrying amount of the loan is determined by current appraised value less estimated costs to sell the underlying collateral, which may be adjusted downward under certain circumstances for actual events and/or changes in market conditions. For example, current average actual selling prices less average actual closing costs on an impaired multi-unit real estate project may indicate the need for an adjustment in the appraised valuation of the project, which in turn could increase the associated ASC Topic 310 specific reserve for the loan. Generally, all appraisals associated with impaired loans are updated on a not less than annual basis.

Loans are considered to have been modified in a TDR when, due to a borrower's financial difficulties, the Company makes unilateral concessions to the borrower that it would not otherwise consider. Concessions could include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Alternatively, management, from time-to-time and in the ordinary course of business, implements renewals, modifications, extensions, and/or changes in terms of loans to borrowers who have the ability to repay on reasonable market-based terms, as circumstances may warrant. Such modifications are not considered to be TDRs, as the accommodation of a borrower's request does not rise to the level of a concession if the modified transaction is at market rates and terms and/or the borrower is not experiencing financial difficulty. For example: (1) adverse weather conditions may create a short term cash flow issue for an otherwise profitable retail business which suggests a temporary interest only period on an amortizing loan; (2) there may be delays in absorption on a real estate project which reasonably suggests extension of the loan maturity at market terms; or (3) there may be maturing loans to borrowers with demonstrated repayment ability who are not in a position at the time of maturity to obtain alternate long-term financing. The most common change in terms provided by the Company is an extension of an interest only term. The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the change in terms, and the exercise of prudent business judgment. The Company had ten TDR’s at September 30, 2015 totaling approximately $15.4 million. Nine of these loans, totaling approximately $15.2 million, are performing under the modified terms, and as a result are not disclosed in the table below. During the nine months of 2015, there were no defaults on restructured loans, as compared to the first nine months of 2014, which had one default totaling approximately $2.1 million on a restructured loan. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. There were no nonperforming TDRs reclassified to nonperforming loans as of September 30, 2015. There was one nonperforming TDR totaling $2.1 million reclassified to nonperforming loans during the nine months ended September 30, 2014. During the nine months ended September 30, 2014, five nonperforming TDRs totaling $8.3 million were removed from TDR status after the loans migrated from nonperforming loans. Two nonperforming TDRs totaling $6.1 million were sold during the second quarter, an owner occupied loan totaling $4.1 million and a commercial loan totaling $2.0 million. One nonperforming TDR totaling approximately $2.0 million was reclassified to OREO after the Company took possession of the underlying collateral. The Company was paid off on another TDR totaling $217 thousand. Finally, one TDR totaling $95 thousand was charged-off. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were three loans modified in a TDR during the three months ended September 30, 2015. For the nine months ended September 30, 2015, there were a total of four loans modified in a TDR. There was one loan modified in a TDR during the three and nine months ended September 30, 2014.

Total nonperforming loans amounted to $14.5 million at September 30, 2015 (0.30% of total loans), compared to $22.4 million at December 31, 2014 (0.52% of total loans) and $29.3 million at September 30, 2014 (0.85% of total loans). The decrease in the ratio of nonperforming loans to total loans at September 30, 2015 as compared to September 30, 2014 was due to a decline in the level of nonperforming loans and to loan growth.

Included in nonperforming assets at September 30, 2015 was $10.0 million of OREO, consisting of ten foreclosed properties. The Company had ten foreclosed properties with a net carrying value of $13.2 million at December 31, 2014 and seven foreclosed properties with a net carrying value of $8.6 million at September 30, 2014. OREO properties are carried at fair value or appraised value less estimated costs to sell. It is the Company's policy to obtain third party appraisals prior to foreclosure, and to obtain updated third party appraisals on OREO properties not less frequently than annually. Generally, the Company would obtain updated appraisals or evaluations where it has reason to believe, based upon market indications (such as comparable sales, legitimate offers below carrying value, broker indications and similar factors), that the current appraisal does not accurately reflect current value. During the first nine months of 2015, five foreclosed properties with a net carrying value of $4.2 million were sold for a net loss of $209 thousand. The decrease in OREO at September 30, 2015, is due to the sale of five OREO properties and a $750 thousand write down of one OREO property.

The following table shows the amounts of nonperforming assets at the dates indicated.

	September 30,		December 31,
(dollars in thousands)	**2015**	**2014**	**2014**
Nonaccrual Loans:			
Commercial	$4,828	$15,431	$ 12,975
Income producing - commercial real estate	6,721	2,553	2,645
Owner occupied - commercial real estate	1,281	3,502	1,324
Real estate mortgage - residential	333	350	346
Construction - commercial and residential	571	6,919	3,697
Construction - C&I (owner occupied)	-	-	-
Home equity	661	588	1,398
Other consumer	72	-	58
Accrual loans-past due 90 days	-	-	-
Total nonperforming loans (1)	14,467	29,343	22,443
Other real estate owned	9,952	8,623	13,224
Total nonperforming assets	$24,419	$37,966	$ 35,667
Coverage ratio, allowance for credit losses to total nonperforming loans	347.82%	153.20%	205.30 %
Ratio of nonperforming loans to total loans	0.30 %	0.85 %	0.52 %
Ratio of nonperforming assets to total assets	0.41 %	0.91 %	0.68 %

(1) Nonaccrual loans reported in the table above include loans that migrated from performing troubled debt restructuring. There were no loans that migrated from performing TDR during the nine months ended September 30, 2015, as compared to the nine months ended September 31, 2014 which had one TDR totaling $2.1 million reclassified to nonperforming loans.

Significant variation in the amount of nonperforming loans may occur from period to period because the amount of nonperforming loans depends largely on the condition of a relatively small number of individual credits and borrowers relative to the total loan portfolio.

At September 30, 2015, there were $25.8 million of performing loans considered potential problem loans, defined as loans that are not included in the 90 day past due, nonaccrual or restructured categories, but for which known information about possible credit problems causes management to be uncertain as to the ability of the borrowers to comply with the present loan repayment terms, which may in the future result in disclosure in the past due, nonaccrual or restructured loan categories. The $25.8 million in potential problem loans at September 30, 2015 compared to $23.9 million at December 31, 2014, and $15.6 million at September 30, 2014. The Company has taken a conservative posture with respect to risk rating its loan portfolio. Based upon their status as potential problem loans, these loans receive heightened scrutiny and ongoing intensive risk management. Additionally, the Company's loan loss allowance methodology incorporates increased reserve factors for certain loans considered potential problem loans as compared to the general portfolio. See “Provision for Credit Losses” for a description of the allowance methodology.

Noninterest Income

Total noninterest income includes service charges on deposits, gain on sale of loans, gain on sale of investment securities, loss on extinguishment of debt, income from BOLI and other income.

Total noninterest income for the nine months ended September 30, 2015 increased to $20.1 million from $13.0 million for the nine months ended September 30, 2014, a 54.5% increase. This increase was primarily due to $5.1 million higher gains on the sale of residential mortgage loans and to gains realized on the sale of investment securities of $2.2 million offset by a $1.1 million loss on the early extinguishment of debt due to the early payoff of FHLB advances. Excluding investment securities gains and the loss on early extinguishment of debt, total noninterest income was $19.0 million for the nine months ended September 30, 2015, as compared to $13.0 million for the same period in 2014, a 46.2% increase.

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Total noninterest income for the three months ended September 30, 2015 increased to $6.1 million from $4.8 million for the three months ended September 30, 2014, a 28% increase. This increase was primarily due to an increase of $1.1 million in gains on the sale of residential mortgage loans, offset by a decrease in SBA gains.

For the nine months ended September 30, 2015, service charges on deposit accounts increased by $352 thousand to $4.0 million from $3.6 million in the same period in 2014, an increase of 10%. For the three months ended September 30, 2015, service charges on deposit accounts increased $147 thousand, an increase of 12% from the same three month period in 2014. The increase for the nine and three month periods was primarily related to growth in the number of accounts.

The Company originates residential mortgage loans and utilizes both “mandatory delivery” and “best efforts” forward loan sale commitments to sell those loans, servicing released. Sales of these mortgage loans yielded gains of $8.7 million for the nine months ended September 30, 2015 compared to $3.6 million in the same period in 2014, as refinancing activity increased beginning in the first quarter of 2015. For the three months ended September 30, 2015 and 2014 gains on the sales of residential mortgages were $2.4 million and $1.3 million, respectively. Loans sold are subject to repurchase in circumstances where documentation is deficient or the underlying loan becomes delinquent or pays off within a specified period following loan funding and sale. The Bank considers these potential recourse provisions to be a minimal risk, but has established a reserve under generally accepted accounting principles for possible repurchases. There were no repurchases due to fraud by the borrower during the nine months ended September 30, 2015. The reserve amounted to $153 thousand at September 30, 2015 and is included in other liabilities on the Consolidated Balance Sheets. The Bank does not originate “sub-prime” loans and has no exposure to this market segment.

The Company is an originator of SBA loans and its practice is to sell the guaranteed portion of those loans at a premium. Income from this source was $694 thousand and $107 thousand for the nine and three months ended September 30, 2015 compared to $1.1 million and $504 thousand for the same nine and three month periods in 2014. Activity in SBA loan sales to secondary markets can vary widely from quarter to quarter.

A $1.1 million loss on the early extinguishment of debt was recorded in March of 2015 due to the early payoff of FHLB advances. This decision was made in light of deposit growth in the quarter and expected benefits to the cost of funds going forward.

Other income totaled $4.5 million for the nine months ended September 30, 2015 as compared to $3.8 million for the same period in 2014, an increase of 19%. ATM fees increased from $870 thousand for the nine months ended September 30, 2014 to $999 thousand for the same period in 2015, a 15% increase. SBA servicing fees increased from $185 thousand for the nine months ended September 30, 2014 to $243 thousand for the same period in 2015, a 31% increase. Noninterest loan fees increased from $1.9 million for the nine months ended September 30, 2014 to $2.5

million for the same period in 2015, a 33% increase. Other noninterest fee income was $711 thousand for the nine months ended September 30, 2015 compared to $807 thousand for the same period in 2014, a 12% decrease.

Other income totaled $1.8 million for the three months ended September 30, 2015 as compared to $1.4 million for the same period in 2014, an increase of 26%. ATM fees increased from $307 thousand for the three months ended September 30, 2014 to $355 thousand for the same period in 2015, a 16% increase. Noninterest loan fees increased from $577 thousand for the three months ended September 30, 2014 to $971 thousand for the same period in 2015, a 68% increase. Other noninterest fee income decreased $105 thousand for the three months ended September 30, 2015 from $481 thousand for the same period in 2014, a 22% decrease.

Noninterest Expense

Total noninterest expenses totaled $82.1 million for the nine months ended September 30, 2015, as compared to $70.4 million ($68.9 million on an operating basis) for the nine months ended September 30, 2014, a 16.6% increase (19.1% on an operating basis). Total noninterest expenses totaled $27.4 million for the three months ended September 30, 2015, as compared to $25.1 million ($24.3 million on an operating basis) for the three months ended September 30, 2014, a 9% increase (13% increase on an operating basis).

Salaries and employee benefits were $45.8 million for the nine months ended September 30, 2015, as compared to $41.6 million for 2014, a 10% increase. Salaries and employee benefits were $15.4 million for the three months ended September 30, 2015, as compared to $14.9 million for the three months ended September 30, 2014, a 3% increase. Cost increases for salaries and benefits for both the nine and three month periods were due primarily to increased staff from the Merger, merit increases, employee benefit expense increases and incentive compensation. At September 30, 2015, the Company's full time equivalent staff numbered 432, as compared to 427 at December 31, 2014 and 389 at September 30, 2014.

Premises and equipment expenses amounted to $12.1 million for the nine months ended September 30, 2015 as compared to $9.6 million for the same period in 2014, a 26% increase. Premises and equipment expenses amounted to $4.0 million for the three months ended September 30, 2015 as compared to $3.4 million for the same period in 2014, an 18% increase. For both the nine and three month periods premises and equipment expenses were higher due to costs of additional branches and office space acquired in the Merger and to increases in leasing costs. Additionally, for the nine and three months ended September 30, 2015, the Company recognized $274 thousand and $112 thousand of sublease revenue as compared to $84 thousand and $26 thousand for the same periods in 2014. The sublease revenue is accounted for as a reduction to premises and equipment expenses.

Marketing and advertising expenses increased from $1.4 million for the nine months ended September 30, 2014 to $2.2 million for the same period in 2015, a 54% increase. Marketing and advertising expenses increased from $544 thousand for the three months ended September 30, 2014 to $762 thousand for the same period in 2015, a 40% increase. The increase in both the nine and three month periods was due to costs associated with digital and print advertising and sponsorships.

Data processing expenses increased from $4.6 million for the nine months ended September 30, 2014 to $5.6 million in the same period in 2015, a 22% increase. Data processing expenses increased from $1.6 million for the three months ended September 30, 2014 to $2.0 million in the same period in 2015, a 26% increase. The increase in expenses for both the nine and three month periods were primarily due to increased accounts and transaction volume primarily arising out of the Merger.

Legal, accounting and professional fees increased from $2.5 million for the nine months ended September 30, 2014 to $2.9 million in the same period in 2015, a 16% increase. Legal, accounting and professional fees increased from $740 thousand for the three months ended September 30, 2014 to $1.1 million in the same period in 2015, a 44% increase. The increase in expenses for both the nine and three month periods were primarily due to professional fees for accounting and legal services.

FDIC insurance premiums were $2.4 million for the nine months ended September 30, 2015, as compared to $1.7 million in 2014, a 40% increase. FDIC insurance premiums were $794 thousand for the three months ended September 30, 2015, as compared to $573 thousand in 2014, a 39% increase. The increase for the both the nine and three month periods were due to higher deposit levels and average asset growth (resulting in part from the Merger) which is a principal factor in the calculation of the amount of insurance premiums.

For the nine months ended September 30, 2015, other expenses amounted to $11.1 million as compared to $7.6 million for the same period in 2014, an increase of 46%. For the three months ended September 30, 2015, other expenses amounted to $3.5 million as compared to $2.5 million for the same period in 2014, an increase of 37%. The major components of cost in this category include core deposit intangible amortization, franchise taxes, director compensation and expenses for the operations of OREO property, as well as valuation adjustments on OREO property. The increase for the both the nine and three month periods was primarily due to costs and valuations associated with OREO, franchise tax and core deposit intangible amortization.

The efficiency ratio, which measures the ratio of noninterest expense to total revenue, improved to 42.86% for the first nine months of 2015 as compared to 50.38% (49.33% on an operating basis) for the same period in 2014. As a percentage of average assets, total noninterest expense (annualized) improved to 1.98% for the first nine months of 2015 as compared to 2.42% (2.37% on an operating basis) for the same period in 2014. For the third quarter of 2015 the efficiency ratio improved to 42.04% as compared to 50.90% (49.11% on an operating basis) for the third quarter of 2014. As a percentage of average assets, total noninterest expense (annualized) improved to 1.88% for the third quarter of 2015 as compared to 2.45% (2.36% on an operating basis) for the same period in 2014. Cost control remains a significant operating objective of the Company.

Income Tax Expense

The Company's ratio of income tax expense to pre-tax income ("effective tax rate") increased to 37.8% for the nine months ended September 30, 2015 as compared to 36.4% for the same period in 2014. For the third quarter of 2015 the effective tax rate was 37.8% compared to 36.4% for the same period in 2014. The higher effective tax rate for the nine and three months ended September 30, 2015 relates to relatively lower levels of tax exempt income.

FINANCIAL CONDITION

Summary

Total assets at September 30, 2015 were $5.89 billion, a 41% increase as compared to $4.17 billion at September 30, 2014, and a 12% increase as compared to $5.25 billion at December 31, 2014. Total loans (excluding loans held for sale) were $4.78 billion at September 30, 2015, a 39% increase as compared to $3.43 billion at September 30, 2014, and an 11% increase as compared to $4.31 billion at December 31, 2014. Loans held for sale amounted to $35.7 million at September 30, 2015 as compared to $41.3 million at September 30, 2014, a 13% decrease, and $44.3 million at December 31, 2014, a 19% decrease. The investment portfolio totaled $524.3 million at September 30, 2015, a 37% increase from the $382.5 million balance at September 30, 2014. As compared to December 31, 2014, the investment portfolio at September 30, 2015 increased by $142.0 million or 37%.

Total deposits at September 30, 2015 were $4.93 billion compared to deposits of $3.53 billion at September 30, 2014, a 39% increase and $4.31 billion at December 31, 2014, a 14% increase. Total borrowed funds (excluding customer repurchase agreements) were $70.0 million at September 30, 2015 as compared to $109.3 million at September 30, 2014, a 36% decrease, and $219.3 million at December 31, 2014, a 68% decrease. The decline in borrowed funds in the first nine months of 2015 as compared to December 31, 2014 was the result of the payoff of all FHLB advances and the $9.3 million in subordinated notes due 2021.

Total shareholders' equity at September 30, 2015 increased to $786.1 million, compared to shareholders' equity of $442.6 million at September 30, 2014, a 78% increase, and $620.8 million at December 31, 2014, a 27% increase. The increases are primarily due to retained earnings, the public offering of common stock completed during the first quarter of 2015, which netted approximately $94.5 million, as well as the issuance of common stock to consummate the Merger. The ratio of common equity to total assets was 12.13% at September 30, 2015 as compared to 9.26% at

September 30, 2014 and 10.46% at December 31, 2014. The Company's capital position remains substantially in excess of regulatory requirements for well capitalized status, with a total risk based capital ratio of 13.80% at September 30, 2015, as compared to 14.48% at September 30, 2014 and 12.97% at December 31, 2014. In addition, the tangible common equity ratio (tangible common equity to tangible assets) was 10.46% at September 30, 2015, compared to 9.19% at September 30, 2014 and 8.54% at December 31, 2014.

Effective January 1, 2015, the Company, Bank, and all other banks of similar size became subject to new capital requirements. These new requirements create a new required ratio for common equity Tier 1 ("CETI") capital, increase the leverage and Tier 1 capital ratios, change the risk weight of certain assets for purposes of the risk-based capital ratios, create an additional capital conservation buffer over the required capital ratios and change what qualifies as capital for purposes of meeting these various capital requirements. Under the new standards for 2015, in order to be considered well-capitalized, the Bank must have a CETI ratio of 6.5% (new), a Tier 1 risk-based ratio of 8.0% (increased from 6.0%), a total risk-based capital ratio of 10.0% (unchanged) and a leverage ratio of 5.0% (unchanged). The Company and the Bank meets all these new requirements, including the full capital conservation buffer; however, beginning in 2016, failure to maintain the required capital conservation buffer would limit the ability of the Company and the Bank to pay dividends, repurchase shares or pay discretionary bonuses.

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Loans, net of amortized deferred fees and costs, at September 30, 2015, December 31, 2014 and September 30, 2014 by major category are summarized below.

	September 30, 2015		December 31, 2014		September 30, 2014	
(dollars in thousands)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Commercial	$1,007,659	21 %	$916,226	21 %	$798,489	23 %
Income producing - commercial real estate	2,022,950	42 %	1,703,172	40 %	1,382,839	41 %
Owner occupied - commercial real estate	489,657	10 %	461,581	11 %	337,422	10 %
Real estate mortgage - residential	147,720	3 %	148,018	3 %	126,263	4 %
Construction - commercial and residential	927,265	20 %	793,432	18 %	634,736	18 %
Construction - C&I (owner occupied)	60,487	1 %	58,032	1 %	41,846	1 %
Home equity	115,346	3 %	122,536	3 %	107,291	3 %
Other consumer	5,881	-	109,402	3 %	3,662	-
Total loans	4,776,965	100 %	4,312,399	100 %	3,432,548	100 %
Less: allowance for credit losses	(50,320)		(46,075)		(44,954)	
Net loans	$4,726,645		$4,266,324		$3,387,594	

In its lending activities, the Company seeks to develop and expand relationships with clients whose businesses and individual banking needs will grow with the Bank. Superior customer service, local decision making, and accelerated turnaround time from application to closing have been significant factors in growing the loan portfolio, and meeting the lending needs in the markets served, while maintaining sound asset quality.

Loans outstanding reached $4.78 billion at September 30, 2015, an increase of $465 million or 11% as compared to $4.31 billion at December 31, 2014, and increased $1.34 billion or 39% as compared to $3.43 billion at September 30, 2014. Growth in loans over the last twelve months was in part due to the Merger, which added approximately $800 million in loans. Excluding balances acquired in the Merger, and the sale of the indirect consumer loan portfolio, organic loan growth over the last twelve months was 18%.

The Company sold the indirect consumer loan portfolio acquired in the Merger, amounting to approximately $80.3 million as of the time of sale. The sale of this non-strategic loan class allows the Company to deploy the funds into commercial and commercial real estate loans, its core competency, improve its yield on earning assets and reduce operating expenses. The estimated loss of approximately $900 thousand has been included as an adjustment to the intangibles established in the Merger. The transaction closed on July 24, 2015.

The loan growth during the first nine months of 2015 was predominantly in the investment commercial real estate, owner occupied commercial real estate, and commercial segments, along with increases in the construction – commercial and residential. Despite an increased level of in-market competition for business, the Bank continued to experience strong organic loan growth across the portfolio. Multi-family commercial real estate leasing in the Bank's market area has held up well, particularly for well-located close-in projects, while suburban office leasing softened somewhat. Overall, commercial real estate values have generally held up well with price escalation in prime pockets. The housing market has remained stable to increasing, with well-located, Metro accessible properties garnering a premium.

Owner occupied commercial real estate and owner occupied commercial real estate construction represent 12% of the loan portfolio. The Bank has a large portion of its loan portfolio related to real estate, with 72% consisting of commercial real estate and real estate construction loans. When only owner occupied commercial real estate is excluded, the percentage of total loans represented by commercial real estate decreases to 62%. Real estate also serves as collateral for loans made for other purposes, resulting in 83% of all loans being secured by real estate.

Deposits and Other Borrowings

The principal sources of funds for the Bank are core deposits, consisting of demand deposits, money market accounts, NOW accounts, and savings accounts. Additionally, the Bank obtains certificates of deposits from the local market areas surrounding the Bank's offices. The deposit base includes transaction accounts, time and savings accounts and accounts which customers use for cash management and which provide the Bank with a source of fee income and cross-marketing opportunities, as well as an attractive source of lower cost funds. To meet funding needs during periods of high loan demand and seasonal variations in core deposits, the Bank utilizes alternative funding sources such as secured borrowings from the FHLB, federal funds purchased lines of credit from correspondent banks and brokered deposits from regional and national brokerage firms and Promontory Interfinancial Network, LLC ("Promontory").

For the nine months ended September 30, 2015, noninterest bearing deposits increased $227 million as compared to December 31, 2014, while interest bearing deposits increased by $389 million during the same period. Average total deposits for the nine months of 2015 were $4.61 billion, as compared to $3.34 billion for the same period in 2014, a 38% increase. Growth in deposits over the last twelve months was in part due to the Merger, which added approximately $645 million in deposits. Excluding balances acquired in the Merger, organic deposit growth over the last twelve months was 21%.

From time to time, when appropriate in order to fund strong loan demand, the Bank accepts brokered time deposits, generally in denominations of less than $100 thousand, from a regional brokerage firm, and other national brokerage networks, including Promontory. Additionally, the Bank participates in the Certificates of Deposit Account Registry Service ("CDARS") and the Insured Cash Sweep product ("ICS"), which provides for reciprocal ("two-way") transactions among banks facilitated by Promontory for the purpose of maximizing FDIC insurance. These reciprocal CDARS and ICS funds are classified as brokered deposits, although bank regulators have recognized that these reciprocal deposits have many characteristics of core deposits. The Bank also is able to obtain one way CDARS deposits and participates in Promontory's Insured Network Deposit ("IND"). At September 30, 2015, total deposits included $580.9 million of brokered deposits (excluding the CDARS and ICS two-way), which represented 12% of total deposits. At December 31, 2014, total brokered deposits (excluding the CDARS and ICS two-way) were $506.5 million, or 12% of total deposits. The CDARS and ICS two-way component represented $625.4 million, or 13% of total deposits and $391.3 million or 9% of total deposits at September 30, 2015 and December 31, 2014, respectively. These sources are believed by the Company to represent a reliable and cost efficient alternative funding source for the Bank. However, to the extent that the condition or reputation of the Company or Bank deteriorates, or to the extent that there are significant changes in market interest rates which the Company and Bank do not elect to match, we may experience an outflow of brokered deposits. In that event we would be required to obtain alternate sources for funding.

At September 30, 2015, the Company had $1.4 billion in noninterest bearing demand deposits, representing 28% of total deposits, compared to $1.18 billion of noninterest bearing demand deposits at December 31, 2014, or 27% of total deposits. These deposits are primarily business checking accounts on which the payment of interest was prohibited by regulations of the Federal Reserve. Since July 2011, banks are no longer prohibited from paying interest on demand deposits account, including those from businesses. To date, the Bank has elected not to pay interest on business checking accounts, nor is the payment of such interest a prevalent practice in the Bank's market area at present. It is not clear over the long-term what effect the elimination of this prohibition will have on the Bank's interest expense, allocation of deposits, deposit pricing, loan pricing, net interest margin, ability to compete, ability to establish and maintain customer relationships, or profitability. Payment of interest on these deposits could have a significant negative impact on the Company's net interest income and net interest margin, net income, and the return on assets and equity, although no such effect is currently anticipated.

As an enhancement to the basic noninterest bearing demand deposit account, the Bank offers a sweep account, or "customer repurchase agreement," allowing qualifying businesses to earn interest on short-term excess funds which are not suited for either a certificate of deposit or a money market account. The balances in these accounts were $64.9 million at September 30, 2015 compared to $61.1 million at December 31, 2014. Customers repurchase agreements are not deposits and are not insured by the FDIC, but are collateralized by U.S. government agency securities and / or

U.S. agency backed mortgage backed securities. These accounts are particularly suitable to businesses with significant fluctuation in the levels of cash flows. Attorney and title company escrow accounts are an example of accounts which can benefit from this product, as are customers who may require collateral for deposits in excess of FDIC insurance limits but do not qualify for other pledging arrangements. This program requires the Bank to maintain a sufficient investment securities level to accommodate the fluctuations in balances which may occur in these accounts.

The Company had no outstanding balances under its federal funds purchase lines of credit provided by correspondent banks at September 30, 2015 and December 31, 2014.

The Bank had no borrowings outstanding under its credit facility from the FHLB at September 30, 2015, compared to $30.0 million of borrowings outstanding at September 30, 2014, and $140 million of borrowings outstanding at December 31, 2014. Outstanding FHLB advances are secured by collateral consisting of a blanket lien on qualifying loans in the Bank's residential and commercial mortgage and home equity loan portfolios.

The Company has a credit facility with a regional bank, secured by a portion of the stock of the Bank, pursuant to which the Company may borrow, on a revolving basis, up to $50 million for working capital purposes, to finance capital contributions to the Bank and ECV. There were no amounts outstanding under this credit at September 30, 2015 or December 31, 2014. For additional information on this credit facility please refer to "Capital Resources and Adequacy" below.

The Company redeemed the remaining balance of $4.1 million of its $9.3 million of subordinated notes, due 2021 during the three months ended September 30, 2015.

The only long-term borrowing outstanding at September 30, 2015 was the Company's August 5, 2014, issuance of $70.0 million of subordinated notes, due September 1, 2024. For additional information on the subordinated notes, please refer to "Capital Resources and Adequacy" below.

Liquidity Management

Liquidity is a measure of the Company's and Bank's ability to meet loan demand and to satisfy depositor withdrawal requirements in an orderly manner. The Bank's primary sources of liquidity consist of cash and cash balances due from correspondent banks, loan repayments, federal funds sold and other short-term investments, maturities and sales of investment securities, income from operations and new core deposits into the Bank. The Bank's investment portfolio of debt securities is held in an available-for-sale status which allows for flexibility, subject to holdings held as collateral for customer repurchase agreements, to generate cash from sales as needed to meet ongoing loan demand. These sources of liquidity are considered primary and are supplemented by the ability of the Company and Bank to borrow funds, which are termed secondary sources and which are substantial. The Company's secondary sources of liquidity include a $50.0 million line of credit with a regional bank, secured by a portion of the stock of the Bank, against which there were no amounts outstanding at September 30, 2015. Additionally, the Bank can purchase up to $137.5 million in federal funds on an unsecured basis from its correspondents, against which there were no amounts outstanding at September 30, 2015, and can obtain unsecured funds under one-way CDARS brokered deposits in the amount of $872.4 million, against which there was $7.1 million outstanding at September 30, 2015. The Bank has a commitment at September 30, 2015 from Promontory to place up to $300.0 million of brokered deposits from its IND program with the Bank in amounts requested by the Bank, as compared to an actual balance of $181.8 million at September 30, 2015. At September 30, 2015, the Bank was also eligible to make advances from the FHLB up to $673.0 million based on collateral at the FHLB, of which there were no amounts outstanding at September 30, 2015. The Bank may enter into repurchase agreements as well as obtain additional borrowing capabilities from the FHLB provided adequate collateral exists to secure these lending relationships. The Bank also has a back-up borrowing facility through the Discount Window at the Federal Reserve Bank of Richmond ("Federal Reserve Bank"). This facility, which amounts to approximately $443.0 million, is collateralized with specific loan assets identified to the Federal Reserve Bank. It is anticipated that, except for periodic testing, this facility would be utilized for contingency funding only.

The loss of deposits, through disintermediation, is one of the greater risks to liquidity. Disintermediation occurs most commonly when rates rise and depositors withdraw deposits seeking higher rates in alternative savings and investment sources than the Bank may offer. The Bank was founded under a philosophy of relationship banking and, therefore, believes that it has less of an exposure to disintermediation and resultant liquidity concerns than do many banks. There is, however, a risk that some deposits would be lost if rates were to increase and the Bank elected not to remain competitive with its deposit rates. Under those conditions, the Bank believes that it is well positioned to use other sources of funds such as FHLB borrowings, brokered deposits, repurchase agreements and correspondent banks' lines of credit to offset a decline in deposits in the short run. Over the long-term, an adjustment in assets and change in business emphasis could compensate for a potential loss of deposits. The Bank also maintains a marketable investment portfolio to provide flexibility in the event of significant liquidity needs. The Asset Liability Committee of the Bank's Board of Directors ("ALCO") has adopted policy guidelines which emphasize the importance of core deposits, adequate asset liquidity and a contingency funding plan.

At September 30, 2015, under the Bank's liquidity formula, it had $2.63 billion of primary and secondary liquidity sources. The amount is deemed adequate to meet current and projected funding needs.

Commitments and Contractual Obligations

Loan commitments outstanding and lines and letters of credit at September 30, 2015 are as follows:

(dollars in thousands)	
Unfunded loan commitments	$1,715,511
Unfunded lines of credit	104,785
Letters of credit	84,896
Total	$1,905,192

Unfunded loan commitments are agreements whereby the Bank has made a commitment and the borrower has accepted the commitment to lend to a customer as long as there is satisfaction of the terms or conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee before the commitment period is extended. In many instances, borrowers are required to meet performance milestones in order to draw on a commitment as is the case in construction loans, or to have a required level of collateral in order to draw on a commitment, as is the case in asset based lending credit facilities. Since commitments may expire without being drawn, the total commitment amount does not necessarily represent future cash requirements.

Unfunded lines of credit are agreements to lend to a customer as long as there is no violation of the terms or conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since commitments may expire without being drawn, the total commitment amount does not necessarily represent future cash requirements.

Letters of credit include standby and commercial letters of credit. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance by the Bank's customer to a third party. Standby letters of credit generally become payable upon the failure of the customer to perform according to the terms of the underlying contract with the third party. Standby letters of credit are generally not drawn. Commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn when the underlying transaction is consummated between the customer and a third party. The contractual amount of these letters of credit represents the maximum potential future payments guaranteed by the Bank. The Bank has recourse against the customer for any amount it is required to pay to a third party under a letter of credit, and holds cash and or other collateral on those standby letters of credit for which collateral is deemed necessary.

Asset/Liability Management and Quantitative and Qualitative Disclosures about Market

A fundamental risk in banking is exposure to market risk, or interest rate risk, since a bank's net income is largely dependent on net interest income. The Bank's ALCO formulates and monitors the management of interest rate risk through policies and guidelines established by it and the full Board of Directors and through review of detailed reports discussed quarterly. In its consideration of risk limits, the ALCO considers the impact on earnings and capital, the level and direction of interest rates, liquidity, local economic conditions, outside threats and other factors. Banking is generally a business of managing the maturity and re-pricing mismatch inherent in its asset and liability cash flows and to provide net interest income growth consistent with the Company's profit objectives.

During the quarter ended September 30, 2015, as compared to the same three months in 2014, the Company was able to increase its net interest income (by 32%), produce a net interest spread of 4.04%, which was 24 basis points lower than the 4.28% for the same quarter ended 2014, and manage its overall interest rate risk position.

The Company, through its ALCO and ongoing financial management practices, monitors the interest rate environment in which it operates and adjusts the rates and maturities of its assets and liabilities to remain competitive and to achieve its overall financial objectives subject to established risk limits. In the current and expected future interest rate environment, the Company has been maintaining its investment portfolio to manage the balance between yield and prepayment risk in its portfolio of mortgage backed securities should interest rates remain at current levels. Further, the company has been managing the investment portfolio to mitigate extension risk and related declines in market values in that same portfolio should interest rates increase. Additionally, the Company has limited call risk in its U.S. agency investment portfolio. During the three months ended September 30, 2015, the average investment portfolio balances increased from the second quarter of 2015 in part from the reinvestment of a portion of the cash flows from the sale of the indirect consumer loan portfolio which closed in late July 2015, amounting to approximately $80.3 million at the time of sale. In addition to the purchase of investments, cash flows from the sale of the indirect consumer loan portfolio provided additional liquidity for loan originations.

As a result of the sale in the first quarter of 2015 of various longer-term municipal investments, the percentage mix of municipal securities decreased to 24% of total investments at September 30, 2015 from 29% at December 31, 2014, the portion of the portfolio invested in mortgage backed securities decreased to 62% at September 30, 2015 from 63% at December 31, 2014, the portion of the portfolio represented in U.S. Government agency investments increased to 13% at September 30, 2015 from 8% at December 31, 2014 and the Company acquired floating rate corporate bonds in June, 2015 which represented 3% of total investment securities at September 30, 2015. Also resulting from the sale of municipal bonds in 2015, the duration of the investment portfolio decreased to 3.7 years at September 30, 2015 from 4.0 years at December 31, 2014, which better prepared the Company for expected increases in market interest rates.

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The re-pricing duration of the loan portfolio was fairly stable at 26 months at September 30, 2015 versus 27 months at December 31, 2014, with fixed rate loans amounting to 37% of total loans at September 30, 2015 compared to 41% of total loans at December 31, 2014. Variable and adjustable rate loans comprised 63% of total loans at September 30, 2015, compared to 59% of total loans at December 31, 2014. Variable rate loans are generally indexed to either the Wall Street Journal prime interest rate, or the one month LIBOR interest rate, while adjustable rate loans are indexed primarily to the five year U.S. Treasury interest rate.

The duration of the deposit portfolio was also fairly stable at 32 months at September 30, 2015, as compared to 34 months at December 31, 2014. The change since December 31, 2014 was due substantially to a slight change in the mix and duration of time deposits.

The Company has continued its emphasis on funding loans in its marketplace, and has been able to achieve favorable loan pricing, including interest rate floors on many loan originations, although competition for new loans persists. A disciplined approach to loan pricing, together with loans floors existing in 57% of total loans (at September 30, 2015), has resulted in a loan portfolio yield of 5.19% for the three months ended September 30, 2015 as compared to 5.39% for the same period in 2014. Subject to interest rate floors, variable and adjustable rate loans provide additional income opportunities should interest rates rise from current levels.

The net unrealized gain before income tax on the investment portfolio was $5.5 million at September 30, 2015 as compared to a net unrealized gain before tax of $4.4 million at December 31, 2014. The higher net unrealized gain on the investment portfolio at September 30, 2015 as compared to December 31, 2014 was due primarily to higher investment balances. At September 30, 2015, the unrealized gain position represented 1% of the investment portfolio's book value.

There can be no assurance that the Company will be able to successfully achieve its optimal asset liability mix, as a result of competitive pressures, customer preferences and the inability to perfectly forecast future interest rates and movements.

One of the tools used by the Company to manage its interest rate risk is a static GAP analysis presented below. The Company also employs an earnings simulation model on a quarterly basis to monitor its interest rate sensitivity and risk and to model its balance sheet cash flows and the related income statement effects in different interest rate scenarios. The model utilizes current balance sheet data and attributes and is adjusted for assumptions as to investment maturities (including prepayments), loan prepayments, interest rates, and the level of noninterest income and noninterest expense. The data is then subjected to a "shock test" which assumes a simultaneous change in interest rates up 100, 200, 300, and 400 basis points or down 100 and 200, along the entire yield curve, but not below zero. The results are analyzed as to the impact on net interest income, net income and the market equity over the next twelve and twenty-four month periods from September 30, 2015. In addition to analysis of simultaneous changes in interest rates along the yield curve, changes based on interest rate “ramps” is also performed. This analysis represents the impact of a more gradual change in interest rates, as well as yield curve shape changes.

For the analysis presented below, at September 30, 2015, the simulation assumes a 50 basis point change in interest rates on money market and interest bearing transaction deposits for each 100 basis point change in market interest rates in a decreasing interest rate shock scenario with a floor of 10 basis points, and assumes a 70 basis point change in interest rates on money market and interest bearing transaction deposits for each 100 basis point change in market interest rates in an increasing interest rate shock scenario.

As quantified in the table below, the Company's analysis at September 30, 2015 shows a moderate effect on net interest income (over the next 12 months) as well as a moderate effect on the economic value of equity when interest rates are shocked both down 100 and 200 basis points and up 100, 200, 300, and 400 basis points. This moderate impact is due substantially to the significant level of variable rate and re-priceable assets and liabilities and related shorter relative durations. The re-pricing duration of the investment portfolio at September 30, 2015 is 3.7 years, the loan portfolio 2.2 years; the interest bearing deposit portfolio 2.7 years and the borrowed funds portfolio 3.6 years.

The following table reflects the result of simulation analysis on the September 30, 2015 asset and liabilities balances:

Change in interest rates (basis points)	**Percentage change in net interest income**	**Percentage change in net income**	**Percentage change in market value of portfolio equity**
+400	+7.6%	+14.5%	-0.3%
+300	+4.4%	+9.1%	-0.7%
+200	+1.3%	+3.8%	-1.2%
+100	-1.2%	-0.2%	-1.4%
0	-	-	-
-100	-1.3%	-2.2%	-6.3%
-200	-3.1%	-5.6%	-12.5%

The results of simulation are within the policy limits adopted by the Company. For net interest income, the Company has adopted a policy limit of 10% for a 100 basis point change, 12% for a 200 basis point change, 18% for a 300 basis point change and 24% for a 400 basis point change. For the market value of equity, the Company has adopted a policy limit of 12% for a 100 basis point change, 15% for a 200 basis point change, 25% for a 300 basis point change and 30% for a 400% basis point change. The changes in net interest income, net income and the economic value of equity in both a higher and lower interest rate shock scenario at September 30, 2015 are not considered to be excessive. The negative impact of -1.2% in net interest income and -0.2% in net income given a 100 basis point increase in market interest rates reflects in large measure the impact of floor interest rates in a substantial portion of the loan portfolio and to a lower level of expected residential mortgage sales activity.

In the third quarter of 2015, the Company continued to manage its interest rate sensitivity position to moderate levels of risk, as indicated in the simulation results above. Except for the higher level of asset liquidity at September 30, 2015 as compared to December 31, 2014, the interest rate risk position at September 30, 2015 was similar to the interest rate risk position at December 31, 2014. As compared to December 31, 2014, the sum of federal funds sold, interest bearing deposits with banks and other short-term investments and loans held for sale increased by $39.8 million at September 30, 2015.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or repricing periods, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate mortgage loans, have features that limit changes in interest rates on a short-term basis and over the life of the loan. Further, in the event of a change in interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their debt may decrease in the event of a significant interest rate increase.

During the third quarter of 2015, average market interest rates increased on the short end of the yield curve, with rates in the five to ten year part of the curve decreasing. Overall, there was a flattening of the yield curve starting with the five year point in the curve and out, as compared to the third quarter of 2014.

As compared to the third quarter of 2014, the average two-year U.S. Treasury rate increased by 18 basis points from 0.50% to 0.68%, the average five year U.S. Treasury rate decreased by 14 basis points from 1.69% to 1.55% and the average ten year U.S. Treasury rate decreased by 27 basis points from 2.49% to 2.22%. The Company’s net interest spread for the third quarter of 2015 was 4.04% compared to 4.28% for the third quarter of 2014. The slight decline was due in large part to a higher mix of liquidity maintained relative to other earning assets. The Company believes that the change in the net interest spread in the most recent quarter as compared to 2014’s third quarter has been consistent with its risk analysis at December 31, 2014.

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GAP Position

Banks and other financial institutions earnings are significantly dependent upon net interest income, which is the difference between interest earned on earning assets and interest expense on interest bearing liabilities. This revenue represented 90% of the Company’s revenue for the third quarter of 2015 and 2014.

In falling interest rate environments, net interest income is maximized with longer term, higher yielding assets being funded by lower yielding short-term funds, or what is referred to as a negative mismatch or GAP. Conversely, in a rising interest rate environment, net interest income is maximized with shorter term, higher yielding assets being funded by longer-term liabilities or what is referred to as a positive mismatch or GAP.

The GAP position, which is a measure of the difference in maturity and repricing volume between assets and liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indication of the sensitivity of the Company to changes in interest rates. A negative GAP indicates the degree to which the volume of repriceable liabilities exceeds repriceable assets in given time periods.

At September 30, 2015, the Company had a positive GAP position of approximately $471.2 million or 8.0% of total assets out to three months and a positive cumulative GAP position of $546.1 million or 9.3% of total assets out to 12 months; as compared to a positive GAP position of approximately $362.6 million or 6.9% of total assets out to three months and a positive cumulative GAP position of approximately $347.1 million or 6.6% out to 12 months at December 31, 2014. The change in the positive GAP position at September 30, 2015, as compared to December 31, 2014, was due substantially to the higher amount of asset liquidity on the balance sheet. The change in the GAP position at September 30, 2015 as compared to December 31, 2014 is not judged material to the Company’s overall interest rate risk position, which relies more heavily on simulation analysis which captures the full optionality within the balance sheet. The current position is within guideline limits established by the ALCO.

While management believes that this overall position creates a reasonable balance in managing its interest rate risk and maximizing its net interest margin within plan objectives, there can be no assurance as to actual results.

Management has carefully considered its strategy to maximize interest income by reviewing interest rate levels, economic indicators and call features within its investment portfolio, as well as interest rate floors within its loan portfolio. These factors have been discussed with the ALCO and management believes that current strategies are appropriate to current economic and interest rate trends.

If interest rates increase by 100 basis points, the Company’s net interest income and net interest margin are expected to decrease modestly due to the impact of loan floors providing no additional interest income and the assumption of an increase in money market interest rates by 70% of the change in market interest rates.

If interest rates decline by 100 basis points, the Company’s net interest income and margin are expected to decline modestly as the impact of lower market rates on a large amount of liquid assets more than offsets the ability to lower interest rates on interest bearing liabilities.

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Because competitive market behavior does not necessarily track the trend of interest rates but at times moves ahead of financial market influences, the change in the cost of liabilities may be different than anticipated by the GAP model. If this were to occur, the effects of a declining interest rate environment may not be in accordance with management's expectations.

GAP Analysis

September 30, 2015

(dollars in thousands)

Repriceable in:	**0-3 months**	**4-12 months**	**13-36 months**	**37-60 months**	**Over 60 months**	**Total Rate Sensitive**	**Non-sensitive**	**Total Assets**
RATE SENSITIVE ASSETS:								
Investment securities	$65,358	$86,793	$108,882	$107,029	$173,129	$541,191		
Loans [(1)(2)]	2,338,678	452,182	1,102,448	765,626	153,744	4,812,678		
Fed funds and other short-term investments	295,352	-	-	-	-	295,352		
Other earning assets	58,284	-	-	-	-	58,284		
Total	$2,757,672	$538,975	$1,211,330	$872,655	$326,873	$5,707,505	$181,453	$5,888,958
RATE SENSITIVE LIABILITIES:								
Noninterest bearing demand	$57,220	$171,660	$457,198	$457,198	$259,171	$1,402,447		
Interest bearing transaction	145,401	-	31,158	31,157	-	207,716		
Savings and money market	1,844,393	-	334,958	334,959	-	2,514,310		
Time deposits	174,564	292,411	315,746	19,394	-	802,115		
Customer repurchase agreements and fed funds	64,893	-	-	-	-	64,893		

purchased								
Other borrowings	-	-	-	-	70,000	70,000		
Total	$2,286,471	$464,071	$1,139,060	$842,708	$329,171	$5,061,481	$41,408	$5,102,889
GAP	$471,201	$74,904	$72,270	$29,947	$(2,298)	$646,024		
Cumulative GAP	$471,201	$546,105	$618,375	$648,322	$646,024			
Cumulative gap as percent of total assets	8.00 %	9.27 %	10.50 %	11.01 %	10.97 %			

(1) Includes loans held for sale.
(2) Nonaccrual loans are included in the over 60 months category.

Although NOW and MMA accounts are subject to immediate repricing, the Bank's GAP model has incorporated a repricing schedule to account for a lag in rate changes based on our experience, as measured by the amount of those deposit rate changes relative to the amount of rate change in assets.

Capital Resources and Adequacy

The assessment of capital adequacy depends on a number of factors such as asset quality and mix, liquidity, earnings performance, changing competitive conditions and economic forces, regulatory measures and policy, as well as the overall level of growth and complexity of the balance sheet. The adequacy of the Company's current and future capital needs is monitored by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

The federal banking regulators have issued guidance for those institutions which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land acquisitions which represent 100% or more of an institution's total risk-based capital; or (2) total commercial real estate loans representing 300% or more of the institution's total risk-based capital and the institution's commercial real estate loan portfolio has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans, and the Company has experienced significant growth in its commercial real estate portfolio in recent years. At September 30, 2015 non-owner-occupied commercial real estate loans (including construction, land and land development loans) represent 445% of total risk based capital. Construction, land and land development loans represent 134% of total risk based capital. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened risk management procedures, and strong underwriting criteria with respect to its commercial real estate portfolio. Monitoring practices include periodic stress testing analysis to evaluate changes to cash flows, owing to interest rate increases and declines in net operating income. Nevertheless, we may be required to maintain higher levels of capital as a result of our commercial real estate concentrations, which could require us to obtain additional capital, and may adversely affect shareholder returns.

The Company has a credit facility with a regional bank, pursuant to which the Company may borrow, on a revolving basis, up to $50 million for working capital purposes, to finance capital contributions to the Bank in whole and to ECV in part. The credit facility is secured by a first lien on a portion of the stock of the Bank, pursuant to which the Company may borrow, and bears interest at a floating rate equal to the Wall Street Journal Prime Rate minus 0.25% with a floor interest rate of 3.50%. Interest is payable on a monthly basis. The term of the credit facility expires on September 30, 2016. There were no amounts outstanding under this credit facility at September 30, 2015, December 31, 2014, or September 30, 2014.

On November 2, 2015, the Company redeemed all of the 56,600 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series B, liquidation amount $1,000 per share (the "Series B Preferred Stock"), and all of the 15,300 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C, liquidation amount $1,000 per share ("Series C Preferred Stock"). The aggregate redemption price of the Series B Preferred Stock and Series C Preferred Stock was approximately $71.96 million, including dividends accrued but unpaid through, but not including, the redemption date.

During the third quarter of 2015, the Company redeemed the outstanding balance of $4.1 million of the $9.3 million of subordinated notes due 2021.

On August 5, 2014, the Company completed the sale of $70.0 million of its noncallable 5.75% subordinated notes, due September 1, 2024. (the "Notes"). The Notes were sold to the public at par. The notes qualify as Tier 2 capital for regulatory purposes to the fullest extent permitted under capital regulations applicable under the Basel III Rule capital requirements.

The Company and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements.

The prompt corrective action regulations provide five categories, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If a bank is only adequately capitalized, regulatory approval is required to, among other things, accept, renew or roll-over brokered deposits. If a bank is undercapitalized, capital distributions and growth and expansion are limited, and plans for capital restoration are required.

In July 2013, the Board of Governors of the Federal Reserve Board and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). Under the final rules, which became applicable to the Company and the Bank on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements will increase for both the quantity and quality of capital held by the Company and the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio (CET1 ratio) of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which when fully phased-in, effectively results in a minimum CET1 ratio of 7.0%. Basel III raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% (which, with the capital conservation buffer, effectively results in a minimum Tier 1 capital ratio of 8.5% when fully phased-in), effectively results in a minimum total capital to risk-weighted assets ratio of 10.5% (with the capital conservation buffer fully phased-in), and requires a minimum leverage ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance-sheet exposures.

In March 2015, the Company completed the public offering of $100 million of its common stock at $35.50 per share and received gross proceeds of sale of $100 million and net proceeds of sale of approximately $94.6 million.

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The actual capital amounts and ratios for the Company and Bank as of September 30, 2015, December 31, 2014 and September 30, 2014 are presented in the table below.

(dollars in thousands)	Company Actual Amount	Company Actual Ratio	Bank Actual Amount	Bank Actual Ratio	Minimun Required For Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Regulations
As of September 30, 2015						
CET1 capital (to risk weighted aseets)	$606,334	10.48%	$595,988	10.36%	4.50%	6.5 %
Total capital (to risk weighted assets)	798,707	13.80%	646,220	11.23%	8.00%	10.0 %
Tier 1 capital (to risk weighted assets)	678,234	11.72%	595,988	10.36%	6.00%	8.0 %
Tier 1 capital (to average assets)	678,234	11.96%	595,988	10.55%	4.00%	5.0 %
As of December 31, 2014						
Total capital (to risk weighted assets)	$631,340	12.97%	$568,637	11.73%	8.00%	10.0 %
Tier 1 capital (to risk weighted assets)	505,864	10.39%	522,637	10.78%	4.00%	6.0 %
Tier 1 capital (to average assets)	505,864	10.69%	522,637	11.09%	3.00%	5.0 %
As of September 30, 2014						
Total capital (to risk weighted assets)	$559,205	14.48%	$452,181	11.76%	8.00%	10.0 %
Tier 1 capital (to risk weighted assets)	434,876	11.26%	407,329	10.60%	4.00%	6.0 %
Tier 1 capital (to average assets)	434,876	10.70%	407,329	10.07%	3.00%	5.0 %

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Company. At September 30, 2015 the Bank could pay dividends to the parent to the extent of its earnings so long as it maintained required capital ratios.

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Use of Non-GAAP Financial Measures

The Company considers the following non-GAAP measurements useful for investors, regulators, management and others to evaluate capital adequacy and to compare against other financial institutions. The tables below provide a reconciliation of these non-GAAP financial measures with financial measures defined by GAAP.

Tangible common equity to tangible assets (the "tangible common equity ratio") and tangible book value per common share are non-GAAP financial measures derived from GAAP-based amounts. The Company calculates the tangible common equity ratio by excluding the balance of intangible assets from common shareholders' equity and dividing by tangible assets. The Company calculates tangible book value per common share by dividing tangible common equity by common shares outstanding, as compared to book value per common share, which the Company calculates by dividing common shareholders' equity by common shares outstanding. The Company considers this information important to shareholders' as tangible equity is a measure that is consistent with the calculation of capital for bank regulatory purposes, which excludes intangible assets from the calculation of risk based ratios.

Non-GAAP Reconciliation (Unaudited)
(dollars in thousands except per share data)

	Nine Months Ended September 30, 2015	Twelve Months Ended December 31, 2014	Nine Months Ended September 30, 2014
Common shareholders' equity	$714,169	$548,859	$386,014
Less: Intangible assets	(109,498)	(109,908)	(3,321)
Tangible common equity	$604,671	$438,951	$382,693
Book value per common share	$21.38	$18.21	$14.83
Less: Intangible book value per common share	(3.28)	(3.65)	(0.12)
Tangible book value per common share	$18.10	$14.56	$14.71
Total assets	$5,888,958	$5,247,880	$4,169,181
Less: Intangible assets	(109,498)	(109,908)	(3,321)
Tangible assets	$5,779,460	$5,137,972	$4,165,860
Tangible common equity ratio	10.46 %	8.54 %	9.19 %

Earnings include the effect of $1.5 million ($1.3 million net of tax) and $885 thousand ($674 thousand net of tax) of merger related expenses for the nine and three months ended September 30, 2014. As the magnitude of the merger expenses distorts the operational results of the Company, we present in the GAAP reconciliation below and certain performance ratios excluding the effect of the merger expenses during the nine and three months periods ended September 30, 2014. We believe this information is important to enable shareholders and other interested parties to assess the core operational performance of the Company.

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Non-GAAP Reconciliation (Unaudited)
(dollars in thousands except per share data)

	Nine Months Ended September 30, 2014	Three Months Ended September 30, 2014
Net income	$ 39,531	$ 14,088
Adjustments to net income		
Merger-related expenses, net of tax	1,250	674
Operating net income	$ 40,781	$ 14,762
Net income available to common shareholders	$ 39,097	$ 13,937
Adjustments to net income available to common shareholders		
Merger-related expenses, net of tax	1,250	674
Operating earnings	$ 40,347	$ 14,611
Earnings per weighted average common share, basic	$ 1.50	$ 0.54
Adjustments to earnings per weighted average common share, basic		
Merger-related expenses, net of tax	0.05	0.03
Operating earnings per weighted average common share, basic	$ 1.55	$ 0.57
Earnings per weighted average common share, diluted	$ 1.47	$ 0.52
Adjustments to earnings per weighted average common share, diluted		
Merger-related expenses, net of tax	0.05	0.03
Operating earnings per weighted average common share, diluted	$ 1.52	$ 0.55
Summary Operating Results:		
Noninterest expense	$ 70,376	$ 25,143
Merger-related expenses	1,460	885
Adjusted noninterest expense	$ 68,916	$ 24,258
Adjusted efficiency ratio	49.33 %	49.11 %
Adjusted noninterest expense as a % of average assets	2.37 %	2.36 %
Return on average assets		
Net income	$ 39,531	$ 14,088
Adjustments to net income		
Merger-related expenses, net of tax	1,250	674
Operating net income	$ 40,781	$ 14,762
Adjusted return on average assets	1.40 %	1.44 %
Return on average common equity		
Net income available to common shareholders	$ 39,097	$ 13,937
Adjustments to net income available to common shareholders		

Merger-related expenses, net of tax	1,250		674	
Operating earnings	$ 40,347		$ 14,611	
Adjusted return on average common equity	14.79	%	15.22	%

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Please refer to Item 2 of this report, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” under the caption “Asset/Liability Management and Quantitative and Qualitative Disclosure about Market Risk.”

Item 4. Controls and Procedures

The Company’s management, under the supervision and with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, evaluated as of the last day of the period covered by this report the effectiveness of the operation of the Company’s disclosure controls and procedures, as defined in Rule 13a-14 under the Securities and Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective. There were no changes in the Company’s internal controls over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the quarter ended September 30, 2015 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

From time to time the Company may become involved in legal proceedings. At the present time there are no proceedings which the Company believes will have a material adverse impact on the financial condition or earnings of the Company.

Item 1A – Risk Factors

There have been no material changes as of September 30, 2015 in the risk factors from those disclosed in the Company's Annual Report on From 10-K for the year ended December 31, 2014.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

(a) *Sales of Unregistered Securities.*	None
(b) *Use of Proceeds.*	Not Applicable
(c) *Issuer Purchases of Securities.*	None

Item 3 - Defaults Upon Senior Securities	None
Item 4 - Mine Safety Disclosures	Not Applicable

Item 5 - Other Information

(a) Required 8-K Disclosures	None

(b) *Changes in Procedures for Director Nominations* None

Item 6 - Exhibits

3.1	Certificate of Incorporation of the Company, as amended (1)
3.2	Articles Supplementary to the Articles of Incorporation for the Series B Preferred Stock (2)
3.3	Bylaws of the Company (3)
3.4	Articles Supplementary to the Articles of Incorporation for the Series C Preferred Stock (4)
4.1	Warrant to Purchase Common Stock (5)
4.4	Subordinated Indenture, dated as of August 5, 2014, between the Company and Wilmington Trust, National Association, as Trustee (6)
4.5	First Supplemental Indenture, dated as of August 5, 2014,

	between the Company and Wilmington Trust, National Association, as Trustee (7)
4.6	Form of Global Note representing the 5.75% Subordinated Notes due September 1, 2024 (included in Exhibit 4.5)
10.1	1998 Stock Option Plan (8)
10.2	2006 Stock Plan (9)
10.3	Amended and Restated Employment Agreement dated as of August 1, 2014, between EagleBank and James H. Langmead (10)
10.4	Amended and Restated Employment Agreement dated as of August 1, 2014, between EagleBank and Antonio F. Marquez (11)
10.5	Amended and Restated Employment Agreement dated as of January 1, 2014, between Eagle Bancorp, Inc., EagleBank and Ronald D.

	Paul (12)
10.6	Amended and Restated Employment Agreement dated as of August 1, 2014, between EagleBank and Susan G. Riel (13)
10.7	Amended and Restated Employment Agreement dated as of August 1, 2014, between EagleBank and Janice L. Williams (14)

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10.8	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and James H. Langmead (15)
10.9	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Antonio F. Marquez (16)
10.10	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Ronald D. Paul (17)
10.11	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Susan G. Riel (18)
10.12	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Janice L. Williams (19)
10.13	Amended and Restated Employment Agreement dated as of August 1, 2014 between EagleBank and Laurence E. Bensignor (20)
10.14	Amended and Restated Employment Agreement dated as of August 1, 2014 between EagleBank and Michael T. Flynn (21)
10.15	Consulting Agreement, dated October 16, 2015 between Eagle Bancorp, Inc. and Michael T. Flynn (22)
10.16	Vice Chairman Agreement dated as of June 1, 2014 between Eagle Bancorp, Inc., EagleBank and Robert Pincus (23)
10.17	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Laurence E. Bensignor (24)
10.18	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Michael T. Flynn (25)
10.20	Non-Compete Agreement dated as of August 1, 2014, between EagleBank and Robert Pincus (26)
10.22	Form of Supplemental Executive Retirement Plan Agreement (27)
10.23	Director Fee Agreement between Eagle Bancorp, Inc., Eagle Bank and David P. Summers (28)
10.24	2015 Senior Executive Incentive Plan (29)
10.25	Employment Agreement dated as of November 1, 2014 between EagleBank and Charles C. Brockett (30)
10.26	Non-Compete Agreement dated as of November 1, 2014, between EagleBank and Charles C. Brockett (31)
10.27	Amended and Restated Employment Agreement dated as of December 15, 2014 between EagleBank and Lindsey S. Rheaume (32)
10.28	Non-Compete Agreement dated as of December 15, 2014, between EagleBank and Lindsey S. Rheaume (33)
10.29	Virginia Heritage Bank 2006 Stock Option Plan (34)
10.30	Virginia Heritage Bank 2010 Long-Term Incentive Plan (35)
11	Statement Regarding Computation of Per Share Income See Note 8 of the Notes to Consolidated Financial Statements
21	Subsidiaries of the Registrant
31.1	Certification of Ronald D. Paul
31.2	Certification of James H. Langmead
32.1	Certification of Ronald D. Paul
32.2	Certification of James H. Langmead
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets at September 30, 2015, December 31, 2014 and September 30, 2014 (ii) Consolidated Statement of Operations for the three and nine months ended September 30, 2015 and 2014 (iii) Consolidated Statement of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014 (iv) Consolidated Statement of Changes in Shareholders’ Equity for the nine months ended September 30, 2015 and 2014 (v) Consolidated Statement of Cash Flows for the nine months ended September 30, 2015 and 2014 (vi) Notes to the Consolidated Financial Statements

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(1) Incorporated by reference to the Exhibit of the same number to the Company's Current Report on Form 8-K filed on July 16, 2008.

(2) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 15, 2011.

(3) Incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on June 27, 2012.

(4) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on November 5, 2014.

(5) Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 8, 2008.

(6) Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on August 5, 2014.

(7) Incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on August 5, 2014.

(8) Incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended December 31, 1998.

(9) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (No. 333-187713)

(10) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 15, 2014.

(11) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 15, 2014.

(12)	Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(13)	Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(14)	Incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(15)	Incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(16)	Incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(17)	Incorporated by reference to Exhibit 10.7 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(18)	Incorporated by reference to Exhibit 10.8 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(19)	Incorporated by reference to Exhibit 10.9 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(20)	Incorporated by reference to Exhibit 10.10 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(21)	Incorporated by reference to Exhibit 10.11 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(22)	Exhibit 33 to the Company's Form 10-Q for the Quarter ended September 30, 2015.
(23)	Incorporated by reference to Exhibit 10.13 to the Company's Current Report on Form 8-K filed on December 15, 2014.

(24) Incorporated by reference to Exhibit 10.14 to the Company’s Current Report on Form 8-K filed on December 15, 2014.

(25) Incorporated by reference to Exhibit 10.15 to the Company’s Current Report on Form 8-K filed on December 15, 2014.

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(26)	Incorporated by reference to Exhibit 10.17 to the Company's Current Report on Form 8-K filed on December 15, 2014.
(27)	Incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the Year ended December 31, 2013.
(28)	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 5, 2014.
(29)	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 28, 2015.
(30)	Incorporated by reference to Exhibit 4 to

the Company's Form 10-Q for the Quarter ended March 31, 2015.

(31) Incorporated by reference to Exhibit 4 to the Company's Form 10-Q for the Quarter ended March 31, 2015.

(32) Incorporated by reference to Exhibit 4 to the Company's Form 10-Q for the Quarter ended March 31, 2015.

(33) Incorporated by reference to Exhibit 4 to the Company's Form 10-Q for the Quarter ended March 31, 2015.

(34) Incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (No. 333-199875)

(35) Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8

(No.
333-199875)

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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.

	EAGLE BANCORP, INC.	
Date: November 9, 2015	By:	/s/ Ronald D. Paul Ronald D. Paul, Chairman, President and Chief Executive Officer of the Company
Date: November 9, 2015	By:	/s/ James H. Langmead James H. Langmead, Executive Vice President and Chief Financial Officer of the Company

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