

PROSPERITY BANCSHARES INC

Form 10-Q

November 09, 2010

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010**

**OR**

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

**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**COMMISSION FILE NUMBER: 000-25051**

**PROSPERITY BANCSHARES, INC.<sup>®</sup>**

(Exact name of registrant as specified in its charter)

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<b>TEXAS</b> (State or other jurisdiction of incorporation or organization)	<b>74-2331986</b> (I.R.S. Employer Identification No.)
<b>Prosperity Bank Plaza</b>	
<b>4295 San Felipe</b>	
<b>Houston, Texas 77027</b>	
(Address of principal executive offices, including zip code)	
<b>(713) 693-9300</b>	
(Registrant's telephone number, including area code)	

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

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

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

Large Accelerated Filer <input checked="" type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-accelerated Filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>

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

As of November 4, 2010, there were 46,663,484 outstanding shares of the registrant's Common Stock, par value \$1.00 per share.

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**PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES**

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	September 30, 2010 (In thousands, except share data)	December 31, 2009
ASSETS		
Cash and due from banks	\$ 140,678	\$ 194,963
Federal funds sold	553	354
Total cash and cash equivalents	141,231	195,317
Securities available for sale, at fair value (amortized cost of \$442,949 and \$573,648, respectively)	469,817	599,503
Securities held to maturity, at cost (fair value of \$4,162,686 and \$3,633,753, respectively)	4,002,822	3,518,787
Loans held for investment	3,413,819	3,376,703
Allowance for credit losses	(51,354)	(51,863)
Loans, net	3,362,465	3,324,840
Accrued interest receivable	29,666	30,571
Goodwill	923,933	876,987
Core deposit intangibles, net of accumulated amortization of \$48,206 and \$41,362, respectively	30,948	35,385
Bank premises and equipment, net	159,717	148,855
Other real estate owned	11,233	7,829
Bank Owned Life Insurance (BOLI)	32,623	48,091
Federal Home Loan Bank stock	15,355	16,019
Other assets	58,692	48,216
TOTAL ASSETS	\$ 9,238,502	\$ 8,850,400
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 1,623,078	\$ 1,492,612
Interest-bearing	5,868,502	5,765,938
Total deposits	7,491,580	7,258,550
Other borrowings	71,686	26,140
Securities sold under repurchase agreements	96,416	72,596
Accrued interest payable	4,936	7,343
Other liabilities	52,049	42,261
Junior subordinated debentures	92,265	92,265
Total liabilities	7,808,932	7,499,155

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## COMMITMENTS AND CONTINGENCIES

### SHAREHOLDERS' EQUITY:

Preferred stock, \$1 par value; 20,000,000 shares authorized; none issued or outstanding		
Common stock, \$1 par value; 200,000,000 shares authorized; 46,690,572 and 46,577,968 shares issued at September 30, 2010 and December 31, 2009, respectively; 46,653,484 and 46,540,880 shares outstanding at September 30, 2010 and December 31, 2009, respectively		
	46,690	46,578
Capital surplus	874,779	870,460
Retained earnings	491,243	418,008
Accumulated other comprehensive income net unrealized gain on available for sale securities, net of tax of \$9,404 and \$9,049, respectively	17,465	16,806
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders' equity	1,429,570	1,351,245

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 9,238,502	\$ 8,850,400
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See notes to interim condensed consolidated financial statements.

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

	Three Months Ended September 30, 20102009		Nine Months Ended September 30, 20102009	
	(Dollars in thousands, except per share data)			
INTEREST INCOME:				
Loans, including fees	\$ 52,855	\$ 54,809	\$ 156,989	\$ 165,859
Securities	43,382	46,812	134,999	143,990
Federal funds sold	10	74	113	180
Total interest income	96,247	101,695	292,101	310,029
INTEREST EXPENSE:				
Deposits	14,702	22,694	49,760	77,772
Junior subordinated debentures	857	879	2,447	2,957
Federal funds purchased and other borrowings	259	389	770	1,340
Securities sold under repurchase agreements	162	320	485	948
Total interest expense	15,980	24,282	53,462	83,017
NET INTEREST INCOME	80,267	77,413	238,639	227,012
PROVISION FOR CREDIT LOSSES	3,000	7,250	10,685	20,275
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	77,267	70,163	227,954	206,737
NONINTEREST INCOME:				
Customer service fees	13,201	13,554	37,470	38,789
Other	453	1,682	2,458	6,597
Total noninterest income	13,654	15,236	39,928	45,386
NONINTEREST EXPENSE:				
Salaries and employee benefits	22,016	21,507	65,559	64,649
Net occupancy expense	4,036	3,624	11,178	11,116
Data processing	1,550	1,446	4,707	5,063
Core deposit intangible amortization	2,274	2,479	6,844	7,635
Depreciation expense	2,161	2,100	6,314	6,170
Other	10,556	10,045	30,765	34,891
Total noninterest expense	42,593	41,201	125,367	129,524
INCOME BEFORE INCOME TAXES	48,328	44,198	142,515	122,599
PROVISION FOR INCOME TAXES	16,162	14,876	47,605	41,289

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NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$ 32,166	\$ 29,322	\$ 94,910	\$ 81,310
EARNINGS PER SHARE				
Basic	\$ 0.69	\$ 0.64	\$ 2.04	\$ 1.76
Diluted	\$ 0.69	\$ 0.63	\$ 2.03	\$ 1.76

See notes to interim condensed consolidated financial statements.

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

	<b>Common Stock Shares</b>	<b>Common Stock Amount</b>	<b>Capital Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Treasury Stock</b>	<b>Total Shareholders' Equity</b>
	<b>(In thousands, except share and per share data)</b>						
BALANCE AT JANUARY 1, 2009	46,116,801	\$ 46,117	\$ 867,380	\$ 332,363	\$ 9,853	\$ (607)	\$ 1,255,106
Comprehensive income:							
Net income available to common shareholders				111,879			111,879
Net change in unrealized gain on available for sale securities (net of tax of \$3,744)					6,953		6,953
Total comprehensive income							118,832
Common stock issued in connection with the exercise of stock options and restricted stock awards	461,167	461	1,565				2,026
Stock based compensation expense			1,515				1,515
Cash dividends declared, \$0.568 per share				(26,234)			(26,234)
BALANCE AT DECEMBER 31, 2009	46,577,968	46,578	870,460	418,008	16,806	(607)	1,351,245
Comprehensive income:							
Net income available to common shareholders				94,910			94,910
Net change in unrealized gain on available for sale securities (net of tax of \$355)					659		659
Total comprehensive income							95,569
Common stock issued in connection with the exercise of stock options and restricted stock awards	112,604	112	2,108				2,220
Stock based compensation expense			2,211				2,211
Cash dividends declared, \$0.465 per share				(21,675)			(21,675)
BALANCE AT SEPTEMBER 30, 2010	46,690,572	\$ 46,690	\$ 874,779	\$ 491,243	\$ 17,465	\$ (607)	\$ 1,429,570

See notes to interim condensed consolidated financial statements.



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

	<div> <div>Nine Months Ended</div> <div>September 30,</div> <div>20102009</div> </div> <div>(Dollars in thousands)</div>	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 94,910	\$ 81,310
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,158	13,805
Provision for credit losses	10,685	20,275
Securities premium amortization (discount accretion), net	13,858	(972)
Net (accretion)/amortization of loan and time deposit discount/premium	(970)	(5,644)
Net loss (gain) on sale of other real estate	3,347	(552)
Net gain on sale of premises, equipment and other assets	(400)	(277)
Proceeds from held for sale loans		99
Stock-based compensation expense	2,211	887
Decrease in other assets and accrued interest receivable	6,517	2,540
Increase (decrease) in accrued interest payable and other liabilities	5,369	(33,295)
Net cash provided by operating activities	148,685	78,176
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of held to maturity securities	846,929	664,477
Purchase of held to maturity securities	(1,345,874)	(945,836)
Proceeds from maturities and principal paydowns of available for sale securities	1,131,749	799,173
Purchase of available for sale securities	(999,998)	(599,999)
Net decrease in loans	52,740	125,881
Purchase of bank premises and equipment	(12,253)	(33,597)
Net decrease in interest-bearing deposits in financial institutions		106
Proceeds from sale of bank premises, equipment, other real estate and other assets	28,184	19,739
Cash and cash equivalents acquired in the purchase of U.S. Bank branches	344,722	
Premium paid for U.S. Bank branches	(13,136)	
Cash and cash equivalents acquired in the purchase of First Bank branches	379,771	
Premium paid for First Bank branches	(26,876)	
Purchase of Banco Popular branches		(50)
Purchase of 1 <sup>st</sup> Choice Bancorp		(17)
Purchase of Franklin Bank branches		(836)
Net cash provided by investing activities	385,958	29,041

*(Table continued on following page)*



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	Nine Months Ended September 30, 20102009 (Dollars in thousands)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in noninterest-bearing deposits	\$ 1,954	\$ (52,610)
Net decrease in interest-bearing deposits	(636,787)	(137,695)
Net proceeds of other short-term borrowings	57,000	26,000
Repayments of other long-term borrowings	(11,454)	(1,540)
Net increase in securities sold under repurchase agreements	20,013	4,619
Proceeds from exercise of stock options	2,220	1,257
Payments of cash dividends	(21,675)	(19,019)
Net cash used in financing activities	(588,729)	(178,988)
NET DECREASE IN CASH AND CASH EQUIVALENTS	\$ (54,086)	\$ (71,771)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	195,317	228,633
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 141,231	\$ 156,862
NONCASH ACTIVITIES:		
SUPPLEMENTAL DISCLOSURES:		
Cash paid for income taxes	\$ 48,977	\$ 44,300
Cash paid for interest	55,659	89,255
See notes to interim condensed consolidated financial statements.		

**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2010****(UNAUDITED)****1. BASIS OF PRESENTATION**

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

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the statements reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. These financial statements and the notes thereto should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2009. Operating results for the nine month period ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 or any other period.

**2. EARNINGS PER SHARE**

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>(In thousands, except per share amounts)</b>			
Net income available to common shareholders	\$ 32,166	\$ 29,322	\$ 94,910	\$ 81,310
Weighted average common shares outstanding	46,640	46,125	46,604	46,106
Potential dilutive common shares	134	222	231	137
Weighted average common shares and equivalents outstanding	46,774	46,347	46,835	46,243
Basic earnings per common share	\$ 0.69	\$ 0.64	\$ 2.04	\$ 1.76
Diluted earnings per common share	\$ 0.69	\$ 0.63	\$ 2.03	\$ 1.76

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period. Diluted earnings per share is computed using the weighted-average number of shares determined for the basic computation plus the dilutive effect of stock options and non-vested restricted stock granted using the treasury stock method. There were no stock options exercisable at September 30, 2010 and 2009 that would have had an anti-dilutive effect on the above computation.

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**PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES**

**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**SEPTEMBER 30, 2010**

**(UNAUDITED)**

**3. NEW ACCOUNTING STANDARDS**

*Accounting Standards Updates*

*Accounting Standards Update (ASU) No. 2009-16, Transfers and Servicing (Topic 860) Accounting for Transfers of Financial Assets.* ASU 2009-16 amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. ASU 2009-16 eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. ASU 2009-16 also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The provisions of ASU 2009-16 became effective on January 1, 2010 and did not have a significant impact on the Company's financial statements.

*ASU No. 2009-17, Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities.* ASU 2009-17 amends prior guidance to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. ASU 2009-17 requires additional disclosures about the reporting entity's involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its effect on the entity's financial statements. ASU No. 2010-10, Consolidations (Topic 810), deferred the effective date of ASU 2009-17 for a reporting entity's interests in investment companies. The provisions of ASU 2009-17 became effective on January 1, 2010 and did not have a significant impact on the Company's financial statements.

*ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures About Fair Value Measurements.* ASU 2010-06 requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) a company should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required for the Company beginning January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective for the Company on January 1, 2010 (see Note 4 Fair Value), and did not have a significant impact on the Company's financial statements.

*ASU No. 2010-20, Receivables (Topic 830) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.* ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 will be effective for the Company's financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period will be required for the Company's financial statements that include periods beginning on or after January 1, 2011.



**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****SEPTEMBER 30, 2010****(UNAUDITED)****4. FAIR VALUE DISCLOSURES**

Effective January 1, 2008, the Company adopted FASB ASC Topic 820, *Fair Value Measurement and Disclosures*. ASC Topic 820, which defines fair value, addresses aspects of the expanding application of fair value accounting and establishes a consistent framework for measuring fair value. Fair value represents the estimated price that would be received from selling an asset or paid to transfer a liability, otherwise known as an exit price.

***Fair Value Hierarchy***

ASC Topic 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with ASC Topic 820, these inputs are summarized in the three broad levels listed below:

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

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

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

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to ASC Topic 820.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities (at fair value):				
U.S Treasury securities and obligations of U.S. government agencies	\$	\$ 1,009	\$	\$ 1,009
States and political subdivisions (including QZAB)		51,617		51,617
Corporate debt securities and other		9,335		9,335
Collateralized mortgage obligations		999		999
Mortgage-backed securities		406,857		406,857

TOTAL	\$	\$ 469,817	\$	\$ 469,817
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**PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES**

**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**SEPTEMBER 30, 2010**

**(UNAUDITED)**

Certain assets and liabilities are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). These instruments include other real estate owned, repossessed assets and impaired loans per ASC Topic 310, *Receivables*. For the nine months ended September 30, 2010, the Company had additions to impaired loans of \$17.4 million and additions to other real estate owned of \$33.5 million, of which \$3.2 million and \$8.7 million were outstanding at September 30, 2010, respectively. The remaining financial assets and financial liabilities measured at fair value on a non-recurring basis that were recorded in 2010 and remained outstanding at September 30, 2010 were not significant.

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. FASB ASC Topic 820 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

These fair value disclosures represent the Company's estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of the various instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.

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

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

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

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

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

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

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

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

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

**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****SEPTEMBER 30, 2010****(UNAUDITED)**

**Off-Balance Sheet Financial Instruments** The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the present creditworthiness of the counterparties. The Company's off-balance sheet commitments are funded at current market rates at the date they are drawn upon. It is management's opinion that the fair value of these commitments would approximate their carrying value, if drawn upon.

FASB ASC Topic 825, *Financial Instruments*, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The carrying amount and estimated fair values of the Company's financial instruments for the dates indicated are as follows:

	<b>September 30, 2010</b>		<b>December 31, 2009</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
	<b>(Dollars in thousands)</b>			
<b>Financial assets:</b>				
Cash and due from banks	\$ 140,678	\$ 140,678	\$ 194,963	\$ 194,963
Federal funds sold	553	553	354	354
Available for sale securities	469,817	469,817	599,503	599,503
Held to maturity securities	4,002,822	4,162,686	3,518,787	3,633,753
Loans held for investment (net of allowance for credit losses)	3,362,465	3,358,337	3,324,840	3,328,393
<b>Total</b>	<b>\$ 7,976,335</b>	<b>\$ 8,132,071</b>	<b>\$ 7,638,447</b>	<b>\$ 7,756,966</b>
<b>Financial liabilities:</b>				
Deposits	\$ 7,491,580	\$ 7,506,776	\$ 7,258,550	\$ 7,279,201
Other borrowings	71,686	73,639	26,140	27,331
Securities sold under repurchase agreements	96,416	96,416	72,596	72,596
Junior subordinated debentures	92,265	92,357	92,265	92,538
<b>Total</b>	<b>\$ 7,751,947</b>	<b>\$ 7,769,188</b>	<b>\$ 7,449,551</b>	<b>\$ 7,471,666</b>

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

**5. GOODWILL AND CORE DEPOSIT INTANGIBLES**

Changes in the carrying amount of the Company's goodwill and core deposit intangibles (CDI) for nine months ended September 30, 2010 were as follows:

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	Goodwill	Core Deposit Intangibles
	( Dollars in thousands)	
Balance as of December 31, 2009	\$ 876,987	\$ 35,385
Amortization		(6,844)
Acquisition of First Bank branches	34,018	2,038
Acquisition of U.S. Bank branches	12,928	369
Balance as of September 30, 2010	\$ 923,933	\$ 30,948

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Purchase accounting adjustments to prior year acquisitions were made to adjust deferred tax asset and liability balances. Goodwill is recorded on the acquisition date of each entity. The Company may record subsequent adjustments to goodwill for amounts undeterminable at acquisition date, such as deferred taxes and real estate valuations, and therefore the goodwill amounts reflected in the table above may change accordingly. The Company initially records the total premium paid on acquisitions as goodwill. After finalizing the valuation, core deposit intangibles are identified and reclassified from goodwill to core deposit intangibles on the balance sheet. This reclassification has no effect on total assets, liabilities, shareholders' equity, net income or cash flows. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangibles has occurred. If any such impairment is determined, a write down is recorded. As of September 30, 2010, there were no impairments recorded on goodwill or other intangibles.

Although the Bank completed the U.S. Bank branch acquisition in March 2010 and the First Bank branch acquisition in April 2010, the Company has not yet finalized the allocation of the purchase price for each respective acquisition.

Core deposit intangibles are amortized on an accelerated basis over their estimated lives, which the Company believes is between 8 and 10 years. Gross core deposit intangibles outstanding were \$79.2 million and \$76.7 million at September 30, 2010 and December 31, 2009, respectively. Net core deposit intangibles outstanding were \$30.9 million and \$35.4 million at the same dates, respectively. Amortization expense related to intangible assets totaled \$2.3 million and \$2.5 million for the three months ended September 30, 2010 and 2009, respectively, and \$6.8 million and \$7.6 million for the nine months ended September 30, 2010 and 2009, respectively. The estimated aggregate future amortization expense for intangible assets remaining as of September 30, 2010 is as follows (dollars in thousands):

Remaining 2010	\$ 2,172
2011	7,780
2012	6,347
2013	4,465
2014	3,314
Thereafter	6,870
Total	\$ 30,948

**6. STOCK BASED COMPENSATION**

At September 30, 2010, the Company had three stock-based employee compensation plans and three stock option plans assumed in connection with acquisitions under which no additional options will be granted. Two of the three plans adopted by the Company have expired and therefore no additional awards may be issued under those plans. The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with ASC Topic 718. ASC Topic 718 was effective for companies in 2006; however, the Company has been recognizing compensation expense since January 1, 2003. The Company recognized \$2.2 million and \$887,000 in stock-based compensation expense for the nine months ended September 30, 2010 and 2009, respectively, and \$729,000 and \$267,000 in stock-based compensation expense for the three months ended September 30, 2010 and 2009, respectively. There was approximately \$684,000 and \$201,000 of income tax benefit recorded for the stock-based compensation expense for the nine months ended September 30, 2010 and 2009, respectively, and \$214,000 and \$56,000 of income tax benefit recorded for the stock-based compensation expense for the three months ended September 30, 2010 and 2009, respectively.



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The Company has granted shares of common stock subject to forfeiture restrictions ( restricted stock ) to certain directors and associates under the Company's 2004 Stock Incentive Plan. The awardee is not entitled to the delivery of the shares until the forfeiture restrictions lapse, which is generally over a 1 to 5 year period; however the awardee is entitled to receive dividends on and vote the shares prior to the lapse of such restrictions. The shares granted do not have a cost to the awardee and the only requirement of the lapse of the forfeiture restriction is continued service to the Company. Compensation cost related to restricted stock is calculated based on the fair value of the shares at the date of grant. If the awardee leaves the Company before the forfeiture restrictions lapse, the unvested shares are forfeited. As of September 30, 2010, there were 353,500 shares of restricted stock outstanding with a weighted average grant date fair value of \$36.52.

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

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

	September 30, 2010	2009
Expected life in years	5.18	5.08
Risk free interest rate	3.86%	3.94%
Volatility	21.20%	21.29%
Dividend yield	1.25%	1.25%

A summary of changes in outstanding vested and unvested options during the nine months ended September 30, 2010 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Options outstanding, beginning of period	856	\$ 25.88		
Options granted				
Options forfeited	(17)	25.40		
Options exercised	(110)	20.14		
Options outstanding, end of period	729	\$ 26.76	4.57	\$ 4,158
Options vested or expected to vest	707	\$ 26.48	4.51	\$ 4,231
Options exercisable, end of period	418	\$ 24.97	3.71	\$ 3,139

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No options were granted during the nine months ended September 30, 2010 and 72,500 options were granted during the nine months ended September 30, 2009. The total intrinsic value of the options exercised during the nine month periods ended September 30, 2010 and 2009 was \$1.4 million and \$1.4 million, respectively. The total fair value of options vested during the nine month periods ended September 30, 2010 and 2009 was \$302,000 and \$263,000, respectively.



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A summary of changes in unvested options is set forth below:

	Nine Months Ended September 30,			
	2010		2009	
	Number of Options (In thousands)	Weighted Average Grant Date Fair Value	Number of Options (In thousands)	Weighted Average Grant Date Fair Value
Unvested options outstanding, beginning of period	376	\$ 6.78	529	\$ 6.83
Options granted			72	6.31
Unvested options forfeited	(15)	6.94	(15)	6.98
Options vested	(51)	5.94	(45)	5.70
Unvested options outstanding, end of period	310	\$ 6.88	541	\$ 6.82

The Company received \$2.2 million and \$1.3 million in cash from the exercise of stock options during the nine month periods ended September 30, 2010 and 2009, respectively. There was no tax benefit realized from option exercises of the stock-based compensation arrangements during the nine month periods ended September 30, 2010 and 2009.

As of September 30, 2010, there was \$11.1 million of total unrecognized compensation expense related to unvested stock-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 3.3 years.

**7. CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ITEMS*****Contractual Obligations***

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of September 30, 2010 (other than deposit obligations). The payments do not include prepayment options that may be available to the Company. The Company's future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, FHLB notes payable and operating leases as of September 30, 2010 are summarized below. Payments for junior subordinated debentures include interest of \$71.3 million that will be paid over the future periods. The future interest payments were calculated using the current rate in effect at September 30, 2010. With respect to floating interest rates, the payments were determined based on the 3-month LIBOR in effect at September 30, 2010. The current principal balance of the junior subordinated debentures at September 30, 2010 was \$92.3 million. Payments for FHLB notes payable include interest of \$4.4 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

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	<b>Remaining Fiscal 2010</b>	<b>Fiscal 2011-2012</b>	<b>Payments due in:</b>		
			<b>Fiscal 2013-2014</b>	<b>Thereafter</b>	<b>Total</b>
			<b>(Dollars in thousands)</b>		
Junior subordinated debentures	\$ 799	\$ 6,390	\$ 6,390	\$ 149,975	\$ 163,554
Federal Home Loan Bank notes payable	295	4,062	3,258	11,458	19,073
Operating leases	1,440	10,469	7,206	3,350	22,465
<b>Total</b>	<b>\$ 2,534</b>	<b>\$ 20,921</b>	<b>\$ 16,854</b>	<b>\$ 164,783</b>	<b>\$ 205,092</b>

***Off-Balance Sheet Items***

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

The Company's commitments associated with outstanding standby letters of credit and commitments to extend credit as of September 30, 2010 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	<b>Remaining Fiscal 2010</b>	<b>Fiscal 2011-2012</b>	<b>Fiscal 2013-2014</b>	<b>Thereafter</b>	<b>Total</b>
			<b>(Dollars in thousands)</b>		
Standby letters of credit	\$ 2,891	\$ 12,763	\$ 115	\$	\$ 15,769
Commitments to extend credit	56,530	278,674	3,046	140,380	478,630
<b>Total</b>	<b>\$ 59,421</b>	<b>\$ 291,437</b>	<b>\$ 3,161</b>	<b>\$ 140,380</b>	<b>\$ 494,399</b>

**8. SUBSEQUENT EVENTS**

The Company evaluated all events and transactions that occurred after the balance sheet date and determined no reportable subsequent events existed.

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

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

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

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

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

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

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

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

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

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

the concentration of the Company's loan portfolio in loans collateralized by real estate;

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

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

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

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

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

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

government intervention in the U.S. financial system;

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

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increases in FDIC deposit insurance assessments;

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

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

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

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company's interim consolidated financial statements and accompanying notes. This section should be read in conjunction with the Company's interim consolidated financial statements and accompanying notes included elsewhere in this report and with the consolidated financial statements and accompanying notes and other detailed information appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

## ***OVERVIEW***

The Company, a Texas corporation, was formed in 1983 as a vehicle to acquire the former Allied First Bank in Edna, Texas which was chartered in 1949 as The First National Bank of Edna. The Company is a registered financial holding company that derives substantially all of its revenues and income from the operation of its bank subsidiary, Prosperity Bank® ( Prosperity Bank or the Bank ). The Bank provides a wide array of financial products and services to small and medium-sized businesses and consumers. As of September 30, 2010, the Bank operated one hundred seventy-five (175) full-service banking locations; with sixty (60) in the Houston area, twenty (20) in the South Texas area including Corpus Christi and Victoria, thirty-three (33) in the Central Texas, ten (10) in the Bryan/College Station area, twenty-one (21) in East Texas and thirty-one (31) in the Dallas/Fort Worth, Texas area. The Company's headquarters are located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (281) 269-7199. The Company's website address is [www.prosperitybanktx.com](http://www.prosperitybanktx.com). Information contained on the Company's website is not incorporated by reference into this quarterly report on Form 10-Q and is not part of this or any other report.

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

Three principal components of the Company's growth strategy are internal growth, stringent cost control practices and strategic merger transactions. The Company focuses on continual internal growth. Each banking center is operated as a separate profit center, maintaining separate data with respect to its net interest income, efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. The Company also focuses on maintaining stringent cost control practices and policies. The Company has invested significantly in the infrastructure required to centralize many of its critical operations, such as data processing and loan application processing. Management believes that this centralized infrastructure can accommodate substantial additional growth while enabling the Company to minimize operational costs through certain economies of scale. The Company also intends to continue to seek expansion opportunities. On March 29, 2010, the Company purchased three (3) retail branches of U.S. Bank. The three banking centers acquired by the Company were the Texas locations U.S. Bank acquired from the FDIC on October 30, 2009 when U.S. Bank acquired the nine (9) subsidiary banks of FBOP Corporation. On April 30, 2010, the Company purchased nineteen (19) Texas retail branches of First Bank, and subsequently consolidated four of these branches into nearby existing Company banking centers.

Total assets were \$9.24 billion at September 30, 2010 compared with \$8.85 billion at December 31, 2009, an increase of \$388.1 million or 4.4%. Total loans were \$3.41 billion at September 30, 2010 compared with \$3.38 billion at December 31, 2009, an increase of \$37.1 million or 1.1%. Total deposits were \$7.49 billion at September 30, 2010 compared with \$7.26 billion December 31, 2009, an increase of \$233.0 million or 3.2%.

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Shareholders' equity increased \$78.3 million or 5.8%, to \$1.43 billion at September 30, 2010 compared with \$1.35 billion at December 31, 2009.

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### ***CRITICAL ACCOUNTING POLICIES***

The Company's accounting policies are integral to understanding the financial results reported. Accounting policies are described in detail in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity:

*Allowance for Credit Losses* The allowance for credit losses is established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company's loan portfolio. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance for credit losses to the Bank's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers factors such as historical loan loss experience, industry diversification of the Company's commercial loan portfolio, the amount of nonperforming assets and related collateral, the volume, growth and composition of the Company's loan portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the Company's loan portfolio through its internal loan review process and other relevant factors. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. Charge-offs occur when loans are deemed to be uncollectible. The allowance for credit losses includes allowance allocations calculated in accordance with FASB ASC Topic 310, *Receivables*, and allowance allocations determined in accordance with FASB ASC Topic 450, *Contingencies*.

*Goodwill and Intangible Assets* Goodwill and intangible assets that have indefinite useful lives are subject to an impairment test at least annually, or more often, if events or circumstances indicate that it is more likely than not that the fair value of Prosperity Bank, the Company's only reporting unit with assigned goodwill, is below the carrying value of its equity. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of the Company's reporting unit compared with its carrying value. If the carrying amount exceeds the fair value of the reporting unit, a second test is completed comparing the implied fair value of the reporting unit's goodwill to its carrying value to measure the amount of impairment. The Company had no intangible assets with indefinite useful lives at September 30, 2010. Other identifiable intangible assets that are subject to amortization are amortized on an accelerated basis over the years expected to be benefited, which the Company believes is between eight and ten years. These amortizable intangible assets are reviewed for impairment if circumstances indicate their value may not be recoverable based on a comparison of fair value to carrying value. Based on the Company's annual goodwill impairment test as of September 30, 2010, management does not believe any of its goodwill is impaired as of September 30, 2010 because the fair value of the Company's equity exceeded its carrying value. While the Company believes no impairment existed at September 30, 2010 under accounting standards applicable at that date, different conditions or assumptions, or changes in cash flows or profitability, if significantly negative or unfavorable, could have a material adverse effect on the outcome of the Company's impairment evaluation and financial condition or future results of operations.

*Stock-Based Compensation* The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with FASB ASC Topic 718, *Stock Compensation*. ASC 718 was effective for companies in 2006; however, the Company had been recognizing compensation expense since January 1, 2003. The Company's results of operations reflect compensation expense for all employee stock-based compensation, including the unvested portion of stock options granted prior to 2003. ASC 718 requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions.

*Other-Than-Temporarily Impaired Securities* The Company's available for sale securities portfolio is reported at fair value. When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair market value is below amortized cost, additional analysis is performed to determine whether an impairment exists. Available for sale and held to maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, (iii) whether the market decline was affected by macroeconomic conditions, and (iv) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company's results of operations and financial condition.

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### ***RESULTS OF OPERATIONS***

Net income available to common shareholders was \$32.2 million (\$0.69 per common share on a diluted basis) for the quarter ended September 30, 2010 compared with \$29.3 million (\$0.63 per common share on a diluted basis) for the quarter ended September 30, 2009, an increase in net income of \$2.8 million, or 9.7%. The Company posted returns on average common equity of 9.06% and 8.93%, returns on average assets of 1.36% and 1.32% and efficiency ratios of 45.35% and 44.46% for the quarters ended September 30, 2010 and 2009, respectively. The efficiency ratio is calculated by dividing total noninterest expense (excluding credit loss provisions) by net interest income plus noninterest income (excluding net gains and losses on the sale of assets). Additionally, taxes are not part of this calculation.

For the nine months ended September 30, 2010, net income available to common shareholders was \$94.9 million (\$2.03 per common share on a diluted basis) compared with \$81.3 million (\$1.76 per common share on a diluted basis) for the same period in 2009, an increase in net income of \$13.6 million or 16.7%. The Company posted returns on average common equity of 9.08% and 8.39%, returns on average assets of 1.36% and 1.22% and efficiency ratios of 45.07% and 47.60% for the nine months ended September 30, 2010 and 2009, respectively.

#### ***Net Interest Income***

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

Net interest income was \$80.3 million for the quarter ended September 30, 2010 compared with \$77.4 million for the quarter ended September 30, 2009, an increase of \$2.9 million, or 3.7%. Net interest income increased as a result of an increase in average interest-earning assets. Interest-earning assets increased to \$8.09 billion for the quarter ended September 30, 2010 compared with \$7.60 billion for the quarter ended September 30, 2009, an increase of \$488.0 million, or 6.4%. The increase in average interest-earning assets was primarily attributable to an increase in average securities in the quarter ended September 30, 2010 compared with the quarter ended September 30, 2009 resulting from the First Bank and U.S. Bank branch acquisitions.

The net interest margin on a tax equivalent basis decreased 11 basis points to 3.97% for the quarter ended September 30, 2010 compared with 4.08% for the quarter ended September 30, 2009. The average rate paid on interest-bearing liabilities decreased 62 basis points from 1.61% for the quarter ended September 30, 2009 compared with 0.99% for the quarter ended September 30, 2010, while the average yield on earning assets decreased 59 basis points from 5.31% for the quarter ended September 30, 2009 compared with 4.72% for the quarter ended September 30, 2010. Average interest-bearing liabilities increased \$377.4 million and average interest-earning assets increased \$488.0 million for the same periods.

Net interest income increased \$11.6 million, or 5.1%, to \$238.6 million for the nine months ended September 30, 2010 compared with \$227.0 million for the same period in 2009. This increase was mainly attributable to higher average interest-earning assets resulting from an increase in average securities due to the acquisition of the First Bank and U.S. Bank branches and rates paid on interest-bearing liabilities decreasing at a faster pace than the yield on interest-earning assets. The net interest margin on a tax equivalent basis for the nine months ended September 30, 2010 increased 2 basis points to 4.05% compared with 4.03% for the same period in 2009. The average rate paid on interest-bearing liabilities decreased 71 basis points from 1.85% for the nine months ended September 30, 2009 compared with 1.14% for the same period in 2010 and the average yield on earning assets decreased 54 basis points from 5.46% for the nine months ended September 30, 2009 compared with 4.92% for the nine months ended September 30, 2010.



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The following tables set forth, for each category of interest-earning assets and interest-bearing liabilities, the average amounts outstanding, the interest earned or paid on such amounts, and the average rate earned or paid for the quarters ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009. The tables also set forth the average rate paid on total interest-bearing liabilities, and the net interest margin on average total interest-earning assets for the same periods. Except as indicated in the footnotes, no tax-equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended September 30,					
	2010			2009		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate (4)	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate (4)
(Dollars in thousands)						
<b>Assets</b>						
Interest-earning assets:						
Loans	\$ 3,408,322	\$ 52,855	6.15%	\$ 3,431,061	\$ 54,809	6.34%
Securities (1)	4,667,697	43,382	3.72	4,062,796	46,812	4.61
Federal funds sold and other temporary investments	12,812	10	0.31	107,008	74	0.27
Total interest-earning assets	8,088,831	96,247	4.72%	7,600,865	101,695	5.31%
Less allowance for credit losses	(52,577)			(43,610)		
Total interest-earning assets, net of allowance	8,036,254			7,557,255		
Noninterest-earning assets	1,401,467			1,310,292		
Total assets	\$ 9,437,721			\$ 8,867,547		
<b>Liabilities and shareholders' equity</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 1,290,299	\$ 1,967	0.60%	\$ 1,092,719	\$ 2,253	0.82%
Savings and money market accounts	2,240,630	3,658	0.65	1,969,427	4,579	0.92
Certificates of deposit	2,500,341	9,077	1.44	2,685,834	15,862	2.34
Junior subordinated debentures	92,265	857	3.69	92,265	879	3.78
Securities sold under repurchase agreements	94,181	162	0.68	109,961	320	1.15
Federal funds purchased and other borrowings	159,423	259	0.64	49,539	389	3.12
Total interest-bearing liabilities	6,377,139	15,980	0.99%	5,999,745	24,282	1.61%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	1,577,013			1,475,878		
Other liabilities	63,785			77,913		
Total liabilities	8,017,937			7,553,536		
Shareholders' equity	1,419,784			1,314,011		
Total liabilities and shareholders' equity	\$ 9,437,721			\$ 8,867,547		
Net interest rate spread			3.73%			3.70%

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Net interest income and margin (2)	\$ 80,267	3.94%	\$ 77,413	4.04%
Net interest income and margin (tax-equivalent basis) (3)	\$ 81,014	3.97%	\$ 78,111	4.08%

- (1) Yield is based on amortized cost and does not include any component of unrealized gains or losses.
- (2) The net interest margin is equal to net interest income divided by average interest-earning assets.
- (3) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 35%.
- (4) Annualized. Average yield and average rate are calculated on an actual/365 day basis except for the average yield on securities which is calculated on a 30/360 day basis.

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	Nine Months Ended September 30,					
	2010			2009		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate (4) (Dollars in thousands)	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate (4)
<b>Assets</b>						
Interest-earning assets:						
Loans	\$ 3,385,337	\$ 156,989	6.20%	\$ 3,477,972	\$ 165,859	6.38%
Securities (1)	4,497,623	134,999	4.00	4,019,370	143,990	4.78
Federal funds sold and other temporary investments	60,618	113	0.25	98,782	180	0.24
Total interest-earning assets	7,943,578	292,101	4.92%	7,596,124	310,029	5.46%
Less allowance for credit losses	(52,354)			(40,045)		
Total interest-earning assets, net of allowance	7,891,224			7,556,079		
Noninterest-earning assets	1,380,203			1,312,906		
Total assets	\$ 9,271,427			\$ 8,868,985		
<b>Liabilities and shareholders' equity</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 1,351,595	\$ 7,222	0.71%	\$ 1,069,884	\$ 6,557	0.82%
Savings and money market accounts	2,176,350	11,970	0.74	1,884,542	15,255	1.08
Certificates of deposit	2,495,534	30,568	1.64	2,807,532	55,960	2.66
Junior subordinated debentures	92,265	2,447	3.55	92,265	2,957	4.28
Securities sold under repurchase agreements	82,925	485	0.78	95,488	948	1.33
Federal funds purchased and other borrowings	79,127	770	1.30	53,733	1,340	3.33
Total interest-bearing liabilities	6,277,796	53,462	1.14%	6,003,444	83,017	1.85%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	1,535,936			1,490,911		
Other liabilities	64,433			82,492		
Total liabilities	7,878,165			7,576,847		
Shareholders' equity	1,393,262			1,292,138		
Total liabilities and shareholders' equity	\$ 9,271,427			\$ 8,868,985		
Net interest rate spread			3.78%			3.61%
Net interest income and margin (2)		\$ 238,639	4.02%		\$ 227,012	4.00%
Net interest income and margin (tax-equivalent basis) (3)		\$ 240,811	4.05%		\$ 229,096	4.03%

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

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

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- (3) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 35%.
- (4) Annualized. Average yield and average rate are calculated on an actual/365 day basis except for the average yield on securities which is calculated on a 30/360 day basis.

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

<b>Three Months Ended September 30, 2010 vs. 2009</b>			
	<b>Increase (Decrease)</b>		
	<b>Due to</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
<b>(Dollars in thousands)</b>			
<b>Interest-earning assets:</b>			
Loans	\$ (363)	\$ (1,591)	\$ (1,954)
Securities	6,970	(10,400)	(3,430)
Federal funds sold and other temporary investments	(65)	1	(64)
<b>Total increase (decrease) in interest income</b>	<b>6,542</b>	<b>(11,990)</b>	<b>(5,448)</b>
<b>Interest-bearing liabilities:</b>			
Interest-bearing demand deposits	407	(693)	(286)
Savings and money market accounts	631	(1,552)	(921)
Certificates of deposit	(1,095)	(5,690)	(6,785)
Junior subordinated debentures		(22)	(22)
Securities sold under repurchase agreements	(46)	(112)	(158)
Federal funds purchased and other borrowings	863	(993)	(130)
<b>Total increase (decrease) in interest expense</b>	<b>760</b>	<b>(9,062)</b>	<b>(8,302)</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ 5,782</b>	<b>\$ (2,928)</b>	<b>\$ 2,854</b>

<b>Nine Months Ended September 30, 2010 vs. 2009</b>			
	<b>Increase (Decrease)</b>		
	<b>Due to</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
<b>(Dollars in thousands)</b>			
<b>Interest-earning assets:</b>			
Loans	\$ (4,418)	\$ (4,452)	\$ (8,870)
Securities	17,133	(26,124)	(8,991)
Federal funds sold and other temporary investments	(70)	3	(67)
<b>Total increase (decrease) in interest income</b>	<b>12,645</b>	<b>(30,573)</b>	<b>(17,928)</b>
<b>Interest-bearing liabilities:</b>			
Interest-bearing demand deposits	1,727	(1,062)	665
Savings and money market accounts	2,362	(5,647)	(3,285)
Certificates of deposit	(6,219)	(19,173)	(25,392)
Junior subordinated debentures		(510)	(510)
Securities sold under repurchase agreements	(125)	(338)	(463)
Federal funds purchased and other borrowings	633	(1,203)	(570)

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Total decrease in interest expense	(1,622)	(27,933)	(29,555)
Increase (decrease) in net interest income	\$ 14,267	\$ (2,640)	\$ 11,627

**Table of Contents***Provision for Credit Losses*

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

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

The Company made a \$3.0 million provision for credit losses for the quarter ended September 30, 2010 and a \$7.3 million provision for the quarter ended September 30, 2009. The Company made a \$10.7 million provision for credit losses for the nine months ended September 30, 2010 and a \$20.3 million provision for the nine months ended September 30, 2009. The ratio of the allowance for credit losses to end of period nonperforming loans was 551.8% at September 30, 2010 compared with 616.6% at December 31, 2009. The ratio of allowance for credit losses to total loans was 1.50% at September 30, 2010 compared with 1.54% at December 31, 2009. For the quarter ended September 30, 2010, net charge-offs were \$4.4 million compared with net charge-offs of \$2.6 million for the quarter ended September 30, 2009. Net charge-offs were \$11.2 million for the nine months ended September 30, 2010 compared with \$9.9 million for the nine months ended September 30, 2009.

*Noninterest Income*

The Company's primary sources of noninterest income are service charges on deposit accounts, which includes insufficient funds charges and other banking-related service fees. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method. Banking-related service fees include check cashing fees, official check fees, safe deposit box rental and currency handling fees. Noninterest income totaled \$13.7 million for the three months ended September 30, 2010 compared with \$15.2 million for the same period in 2009, a decrease of \$1.6 million, or 10.4%. Noninterest income decreased \$5.5 million, or 12.0%, to \$39.9 million for the nine months ended September 30, 2010 compared with \$45.4 million for the same period in 2009. The decreases during both periods were primarily due to increases in net loss on sale of other real estate and decreases in insufficient funds charges.

The net loss on sale of other real estate was \$1.4 million for the three months ended September 30, 2010 compared with a net gain of \$115,000 for the three months ended September 30, 2009. The net loss on sale of other real estate was \$3.3 million for the nine months ended September 30, 2010 compared with a net gain of \$552,000 for the same period in 2009.

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

	<b>Three Months Ended September 30, 2010</b>		<b>Nine Months Ended September 30, 2010</b>	
	<b>2009</b>		<b>2009</b>	
	<b>(Dollars in thousands)</b>			
Service charges on deposit accounts	\$ 13,201	\$ 13,554	\$ 37,470	\$ 38,789
Banking-related service fees	567	500	1,582	1,491
Brokered mortgage income	64	59	127	296
Investment and trust income	151	99	501	467
Income from leased assets	74	78	221	245
Bank owned life insurance income (BOLI)	349	336	1,274	1,002
Net gain (loss) on sale of assets	1	(20)	400	277
Net (loss) gain on sale of other real estate	(1,364)	115	(3,347)	552
Other noninterest income	611	515	1,700	2,294
<b>Total noninterest income</b>	<b>\$ 13,654</b>	<b>\$ 15,236</b>	<b>\$ 39,928</b>	<b>\$ 45,386</b>





**Table of Contents***Noninterest Expense*

Noninterest expense totaled \$42.6 million for the quarter ended September 30, 2010 compared with \$41.2 million for the quarter ended September 30, 2009, an increase of \$1.4 million, or 3.4%. The increase was primarily due to increases in salaries and employee benefits and increases in general operating expenses related to the acquisition of the First Bank and U.S. Bank branches. Noninterest expense totaled \$125.4 million for the nine months ended September 30, 2010 compared with \$129.5 million for the nine months ended September 30, 2009, a decrease of \$4.2 million, or 3.2%. The decrease was primarily due to a decrease in FDIC insurance premiums. The following table presents, for the periods indicated, the major categories of noninterest expense:

	Three Months Ended September 30, 2010		Nine Months Ended September 30, 2010	
	2009		2009	
			(Dollars in thousands)	
Salaries and employee benefits (1)	\$ 22,016	\$ 21,507	\$ 65,559	\$ 64,649
Non-staff expenses:				
Occupancy and equipment expense	4,036	3,624	11,178	11,116
Depreciation	2,161	2,100	6,314	6,170
Data processing	1,550	1,446	4,707	5,063
Communications expense	1,933	2,034	5,968	6,365
Professional fees	688	637	2,309	2,004
Regulatory assessments and FDIC insurance	2,817	2,436	8,227	11,189
Ad valorem and franchise taxes	1,039	934	2,957	2,808
Core deposit intangibles amortization	2,274	2,479	6,844	7,635
Other	4,079	4,004	11,304	12,525
Total non-staff expenses	20,577	19,694	59,808	64,875
Total noninterest expense	\$ 42,593	\$ 41,201	\$ 125,367	\$ 129,524

(1) Includes stock-based compensation expense of \$729,000 and \$267,000 for the three months ended September 30, 2010 and 2009, respectively, and \$2.2 million and \$887,000 for the nine months ended September 30, 2010 and 2009, respectively.

Salaries and employee benefit expenses were \$22.0 million for the quarter ended September 30, 2010 compared with \$21.5 million for the quarter ended September 30, 2009, an increase of \$509,000, or 2.4%. For the nine months ended September 30, 2010, salaries and employee benefit expenses were \$65.6 million, an increase of \$910,000 or 1.4% compared with \$64.6 million for the nine months ended September 30, 2009. The increase during both periods was principally due to an increase in staff related to the acquisition of the First Bank and U.S. Bank branches. The number of full-time equivalent (FTE) associates employed by the Company was 1,719 at September 30, 2010 and 1,608 at September 30, 2009.

Non-staff expenses increased \$883,000, or 4.5%, to \$20.6 million for the quarter ended September 30, 2010 compared with \$19.7 million during the same period in 2009. Non-staff expenses decreased \$5.1 million, or 7.8%, to \$59.8 million for the nine months ended September 30, 2010 compared to \$64.9 million during the same period in 2009. The decrease was primarily due to a decrease in FDIC insurance premiums resulting from a special assessment of \$4.3 million accrued as of June 30, 2009 and paid on September 30, 2009.

*Income Taxes*

Income tax expense increased \$1.3 million, or 8.6%, to \$16.2 million for the quarter ended September 30, 2010 compared with \$14.9 million for the same period in 2009. For the nine months ended September 30, 2010, income tax expense totaled \$47.6 million, an increase of \$6.3 million

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or 15.3% compared with \$41.3 million for the same period in 2009. Both increases were primarily attributable to higher pretax net earnings for the quarter and nine months ended September 30, 2010 when compared to the same periods in 2009. The effective tax rates for the three months ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009 were 33.4%, 33.7%, 33.4% and 33.7%, respectively.

### ***FINANCIAL CONDITION***

#### *Loan Portfolio*

Total loans were \$3.41 billion at September 30, 2010, an increase of \$37.1 million or 1.1% compared with \$3.38 billion at December 31, 2009.

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The following table summarizes the loan portfolio of the Company by type of loan as of September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009	
	Amount	Percent (Dollars in thousands)	Amount	Percent
Commercial and industrial	\$ 387,294	11.3%	\$ 392,975	11.6%
Real estate:				
Construction and land development	498,400	14.6	557,245	16.5
1-4 family residential	789,859	23.1	709,101	21.0
Home equity	114,846	3.4	117,661	3.5
Commercial mortgages	1,273,100	37.3	1,261,267	37.4
Farmland	96,212	2.8	93,288	2.8
Multifamily residential	83,946	2.5	77,952	2.3
Agriculture	47,705	1.4	42,241	1.3
Consumer (net of unearned discount)	90,212	2.6	102,436	3.0
Other	32,245	0.9	22,537	0.6
Total loans	\$ 3,413,819	100.0%	\$ 3,376,703	100.0%

*Nonperforming Assets*

The Company had \$20.7 million in nonperforming assets at September 30, 2010 and \$16.4 million in nonperforming assets at December 31, 2009, an increase of \$4.3 million or 26.6%. The ratio of nonperforming assets to loans and other real estate was 0.60% at September 30, 2010 compared with 0.48% at December 31, 2009.

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

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

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Nonaccrual loans	\$ 7,530	\$ 6,079
Accruing loans 90 or more days past due	1,776	2,332
Total nonperforming loans	9,306	8,411
Reposessed assets	161	116
Other real estate	11,233	7,829
Total nonperforming assets	\$ 20,700	\$ 16,356
Nonperforming assets to total loans and other real estate	0.60%	0.48%
Nonperforming assets to average earning assets	0.26%	0.22%



**Table of Contents***Allowance for Credit Losses*

Management actively monitors the Company's asset quality and provides specific loss allowances when necessary. Loans are charged-off against the allowance for credit losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations. As of September 30, 2010, the allowance for credit losses amounted to \$51.4 million, or 1.50% of total loans, compared with \$51.9 million, or 1.54% of total loans, at December 31, 2009.

Set forth below is an analysis of the allowance for credit losses for the nine months ended September 30, 2010 and the year ended December 31, 2009:

	<b>As of and for the Nine Months Ended September 30, 2010</b>	<b>As of and for the Year Ended December 31, 2009</b>
	(Dollars in thousands)	
Average loans outstanding	\$ 3,385,337	\$ 3,455,761
Gross loans outstanding at end of period	\$ 3,413,819	\$ 3,376,703
Allowance for credit losses at beginning of period	\$ 51,863	\$ 36,970
Provision for credit losses	10,685	28,775
Charge-offs:		
Commercial and industrial	(1,956)	(3,816)
Real estate and agriculture	(8,688)	(8,585)
Consumer	(1,675)	(2,998)
Recoveries:		
Commercial and industrial	295	275
Real estate and agriculture	153	236
Consumer	677	1,006
Net charge-offs	(11,194)	(13,882)
Allowance for credit losses at end of period	\$ 51,354	\$ 51,863
Ratio of allowance to end of period loans	1.50%	1.54%
Ratio of net charge-offs to average loans (annualized)	0.33%	0.40%
Ratio of allowance to end of period nonperforming loans	551.8%	616.6%

*Securities*

Carrying cost of securities totaled \$4.47 billion at September 30, 2010 compared with \$4.12 billion at December 31, 2009, an increase of \$354.3 million or 8.6%. At September 30, 2010, securities represented 48.4% of total assets compared with 46.5% of total assets at December 31, 2009.

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

	September 30, 2010	December 31, 2009
	(In thousands)	
U.S. Treasury securities and obligations of U.S. government agencies	\$ 14,984	\$ 41,715
States and political subdivisions	95,530	103,074
Corporate debt securities	2,982	3,227
Collateralized mortgage obligations	510,248	296,923
Mortgage-backed securities	3,814,739	3,640,208
Equity securities	7,288	7,288
<b>Total amortized cost</b>	<b>\$ 4,445,771</b>	<b>\$ 4,092,435</b>
<b>Total fair value</b>	<b>\$ 4,632,503</b>	<b>\$ 4,233,256</b>

Management evaluates securities for other-than-temporary impairment ( OTTI ) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held to maturity are generally evaluated for OTTI under FASB ASC Topic 320, *Investments- Debt and Equity Securities*. Certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in ASC Topic 325, *Investments-Other*. The Company currently does not own any securities that are accounted for under ASC Topic 325.

In determining OTTI under ASC Topic 320, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. If applicable, the second segment of the portfolio uses the OTTI guidance provided by ASC Topic 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the ASC Topic 325 model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

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

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Management believes the Company does not intend to sell any debt securities or more likely than not will not be required to sell any debt securities before their anticipated recovery, at which time the Company will receive full value for the securities. Furthermore, management has the ability and intent to hold the securities classified as available for sale that were in a loss position as of September 30, 2010 for a period of time sufficient for an entire recovery of the cost basis of the securities. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2010, management believes any impairment in the Company's securities are temporary and no impairment loss has been realized in the Company's consolidated income statement.

The following tables present the amortized cost and fair value of securities classified as available for sale at September 30, 2010:

	Amortized Cost	September 30, 2010 Gross Unrealized Gains Unrealized Losses (Dollars in thousands)		Fair Value
U.S. Treasury securities and obligations of U.S. government agencies.	\$ 1,003	\$ 6	\$	\$ 1,009
States and political subdivisions (including QZAB)	48,892	2,739	(14)	51,617
Corporate debt securities and other	8,770	565		9,335
Collateralized mortgage obligations	1,020		(21)	999
Mortgage-backed securities	383,264	23,668	(75)	406,857
Total	\$ 442,949	\$ 26,978	\$ (110)	\$ 469,817

The following tables present the amortized cost and fair value of securities classified as held to maturity at September 30, 2010:

	Amortized Cost	September 30, 2010 Gross Unrealized Gains Unrealized Losses (Dollars in thousands)		Fair Value
U.S. Treasury securities and obligations of U.S. government agencies.	\$ 13,981	\$ 970	\$	\$ 14,951
States and political subdivisions	46,638	1,968	(166)	48,440
Corporate debt securities	1,500	196		1,696
Collateralized mortgage obligations	509,228	8,046	(599)	516,675
Mortgage-backed securities	3,431,475	149,452	(3)	3,580,924
Total	\$ 4,002,822	\$ 160,632	\$ (768)	\$ 4,162,686

**Table of Contents***Bank Premises and Equipment*

Premises and equipment, net of accumulated depreciation, totaled \$159.7 million and \$148.9 million at September 30, 2010 and December 31, 2009, respectively, an increase of \$10.9 million or 7.3%. The increase was primarily due to the addition of the First Bank and U. S. Bank branches.

*Deposits*

Total deposits were \$7.49 billion at September 30, 2010 compared with \$7.26 billion at December 31, 2009, an increase of \$233.0 million or 5.5%. At September 30, 2010, noninterest-bearing deposits accounted for approximately 21.7% of total deposits compared with 20.6% of total deposits at December 31, 2009. Interest-bearing demand deposits totaled \$5.87 billion or 78.3% of total deposits at September 30, 2010 compared with \$5.77 billion or 79.4% of total deposits at December 31, 2009.

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

	Nine Months Ended September 30, 2010		Year Ended December 31, 2009	
	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)			
Interest-bearing demand	\$ 1,351,595	0.71%	\$ 1,082,332	0.79%
Regular savings	365,061	0.48	320,530	0.56
Money market savings	1,811,289	0.79	1,590,191	1.11
Time deposits	2,495,534	1.64	2,730,263	2.48
Total interest-bearing deposits	6,023,479	1.10	5,723,316	1.67
Noninterest-bearing deposits	1,535,936		1,488,699	
Total deposits	\$ 7,559,415	0.88%	\$ 7,212,015	1.33%

*Other Borrowings*

The Company utilizes borrowings to supplement deposits to fund its lending and investment activities. Borrowings consist of funds from the Federal Home Loan Bank ( FHLB ) and correspondent banks. FHLB advances are considered short-term, overnight borrowings. At September 30, 2010, the Company had \$57.0 million in FHLB advances and \$14.7 million in FHLB long-term notes payable compared with no FHLB advances and \$26.1 million in FHLB long-term notes payable at December 31, 2009. FHLB advances are available to the Company under a security and pledge agreement. At September 30, 2010, the Company had total funds of \$3.12 billion available under this agreement, of which \$71.7 million was outstanding. The weighted average interest rate paid on the FHLB notes payable at period end was 5.2%. The maturity dates on the FHLB notes payable range from the years 2011 to 2028 and have interest rates ranging from 3.55% to 6.10%. The highest outstanding balance of FHLB advances during the nine months ended September 30, 2010 was \$218.0 million compared with \$231.0 million for the year ended December 31, 2009. The average rate paid on FHLB advances for the nine months ended September 30, 2010 was 0.17%.

At September 30, 2010, the Company had \$96.4 million in securities sold under repurchase agreements compared with \$72.6 million at December 31, 2009, an increase of \$23.8 million or 32.8%.

The following table presents the Company's borrowings at September 30, 2010 and December 31, 2009:



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	September 30, 2010	December 31, 2009
	(In thousands)	
FHLB advances	\$ 57,000	\$
FHLB long-term notes payable	14,686	26,140
Total other borrowings	71,686	26,140
Securities sold under repurchase agreements	96,416	72,596
Total	\$ 168,102	\$ 98,736

**Table of Contents***Junior Subordinated Debentures*

At September 30, 2010 and December 31, 2009, the Company had outstanding \$92.3 million in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts. A summary of pertinent information related to the Company's eight issues of junior subordinated debentures outstanding at September 30, 2010 is set forth in the table below:

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

(1) The 3-month LIBOR in effect as of September 30, 2010 was 0.29%.

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

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

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

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

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

(7) The debentures bore a fixed interest rate of 6.45% until January 23, 2009, when the rate began to float on a quarterly basis based on the 3-month LIBOR plus 2.85%.

**Table of Contents***Liquidity*

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

As of September 30, 2010, the Company had outstanding \$478.6 million in commitments to extend credit and \$15.8 million in commitments associated with outstanding standby letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

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

Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. As of September 30, 2010, the Company had cash and cash equivalents of \$141.2 million compared with \$195.3 million at December 31, 2009, a decrease of \$54.1 million. The decrease was primarily due to a decrease in deposits of \$634.8 million, purchases of securities of \$2.35 billion, purchases of premises and equipment of \$12.3 million, dividends paid of \$21.7 million and premiums paid on the U.S. Bank and First Bank branches of \$40.0 million, partially offset by proceeds from the maturities and repayments of securities of \$1.98 billion, cash acquired with the U.S. Bank and First Bank branch acquisitions, a decrease in loans of \$52.7 million, an increase in securities sold under repurchase agreements of \$20.0 million, net earnings of \$94.9 million, proceeds from the sale of bank premises, equipment and ORE of \$28.2 million, a provision for credit losses of \$10.7 million, net premium amortization of securities of \$13.9 million, proceeds from short-term borrowings of \$57.0 million and depreciation and amortization of \$13.2 million.

*Contractual Obligations*

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of September 30, 2010 (other than deposit obligations). The payments do not include prepayment options that may be available to the Company. The Company's future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, FHLB notes payable and operating leases as of September 30, 2010 are summarized below. Payments for junior subordinated debentures include interest of \$71.3 million that will be paid over the future periods. The future interest payments were calculated using the current rate in effect at September 30, 2010. With respect to floating interest rates, the payments were determined based on the 3-month LIBOR in effect at September 30, 2010. The current principal balance of the junior subordinated debentures at September 30, 2010 was \$92.3 million. Payments for FHLB notes payable include interest of \$4.4 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	Remaining Fiscal 2010	Fiscal 2011-2012	Payments due in:		Total
			Fiscal 2013-2014	Thereafter	
	(Dollars in thousands)				
Junior subordinated debentures	\$ 799	\$ 6,390	\$ 6,390	\$ 149,975	\$ 163,554
Federal Home Loan Bank notes payable	295	4,062	3,258	11,458	19,073
Operating leases	1,440	10,469	7,206	3,350	22,465
Total	\$ 2,534	\$ 20,921	\$ 16,854	\$ 164,783	\$ 205,092

*Off-Balance Sheet Items*

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in its consolidated balance sheets. The Company enters into these transactions to meet the

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financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

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The Company's commitments associated with outstanding standby letters of credit and commitments to extend credit as of September 30, 2010 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Remaining Fiscal 2010	Fiscal 2011-2012	Fiscal 2013-2014	Thereafter	Total
(Dollars in thousands)					
Standby letters of credit	\$ 2,891	\$ 12,763	\$ 115	\$	\$ 15,769
Commitments to extend credit	56,530	278,674	3,046	140,380	478,630
Total	\$ 59,421	\$ 291,437	\$ 3,161	\$ 140,380	\$ 494,399

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### Capital Resources

Total shareholders' equity was \$1.43 billion at September 30, 2010 compared with \$1.35 billion at December 31, 2009, an increase of \$78.3 million or 5.8%. The increase was due primarily to net earnings of \$94.9 million and the issuance of common stock in connection with the exercise of stock options of \$2.2 million, partially offset by dividends paid of \$21.7 million for the nine months ended September 30, 2010.

Both the Board of Governors of the Federal Reserve System with respect to the Company, and the Federal Deposit Insurance Corporation (FDIC) with respect to the Bank, have established certain minimum risk-based capital standards that apply to bank holding companies and federally insured banks. The following table sets forth the Company's total risk-based capital, Tier 1 risk-based capital, and Tier 1 to average assets (leverage) ratios as of September 30, 2010:

<b>Consolidated Capital Ratios:</b>	
Total capital (to risk weighted assets)	14.47%
Tier 1 capital (to risk weighted assets)	13.23%
Tier 1 capital (to average assets)	6.45%

As of September 30, 2010, the Bank's risk-based capital ratios were above the levels required for the Bank to be designated as "well capitalized" by the FDIC. To be designated as "well capitalized", the minimum ratio requirements for the Bank's total risk-based capital, Tier 1 risk-based capital, and Tier 1 to average assets (leverage) capital ratios must be 10.0%, 6.0% and 5.0%, respectively. The following table sets forth the Bank's total risk-based capital, Tier 1 risk-based capital, and Tier 1 to average assets (leverage) capital ratios as of September 30, 2010:

<b>Capital Ratios (Bank Only):</b>	
Total capital (to risk weighted assets)	14.22%
Tier 1 capital (to risk weighted assets)	12.97%
Tier 1 capital (to average assets)	6.32%

The Company and the Bank elected to not participate in the U.S. Department of Treasury Capital Purchase Program, which is a part of the Troubled Asset Relief Program.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The Company uses simulation analysis to examine the potential effects of market changes on net interest income and market value. The Company considers macroeconomic variables, Company strategy, liquidity and other factors as it quantifies market risk. See the Company's Annual Report on Form 10-K, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations-Interest Rate Sensitivity and Liquidity which was filed on March 1, 2010 for further discussion.

### ITEM 4. CONTROLS AND PROCEDURES

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

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*Changes in internal control over financial reporting.* There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

There have been no material changes in the Company's risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

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

a. Not applicable

b. Not applicable

c. Not applicable

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable

**ITEM 4. REMOVED AND RESERVED**

**ITEM 5. OTHER INFORMATION**

Not applicable

**ITEM 6. EXHIBITS**

a. Exhibits:

**Exhibit**

**Number**

**Description of Exhibit**

3.1	Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (Registration No. 333-63267) (the "Registration Statement"))
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3.2	Articles of Amendment to Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006)
3.3	Amended and Restated Bylaws of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 19, 2007)
4.1	Form of certificate representing shares of the Company's common stock (incorporated by reference to Exhibit 4 to the Registration Statement)
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	Interactive Financial Data

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

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

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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.

PROSPERITY BANCSHARES, INC. ®

(Registrant)

Date: 11/09/10

/s/ DAVID ZALMAN  
**David Zalman**  
**Chairman and Chief Executive Officer**

Date: 11/09/10

/s/ DAVID HOLLAWAY  
**David Hollaway**  
**Chief Financial Officer**